

**MEMO# 17163**

March 3, 2004

## **DOL ISSUES PROPOSED REGULATION AND CLASS EXEMPTION CONCERNING AUTOMATIC ROLLOVERS OF CERTAIN MANDATORY DISTRIBUTIONS**

[17163] March 3, 2004 TO: PENSION MEMBERS No. 17-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 20-04 RE: DOL ISSUES PROPOSED REGULATION AND CLASS EXEMPTION CONCERNING AUTOMATIC ROLLOVERS OF CERTAIN MANDATORY DISTRIBUTIONS The Department of Labor has issued a proposed regulation and class prohibited transaction exemption that would provide safe harbor relief for plan fiduciaries in connection with automatic rollovers of certain mandatory distributions to IRAs under section 401(a)(31)(B) of the Internal Revenue Code.<sup>1</sup> The deadline for comments on both proposals is April 1, 2004. Under the proposed regulation,<sup>2</sup> fiduciaries that satisfy the conditions of the safe harbor would be deemed to have satisfied their fiduciary duties under ERISA with respect to both the selection of an IRA provider and the investment of funds in connection with the automatic rollover. The proposed regulation, however, would not constitute the exclusive means of satisfying these fiduciary duties. The six proposed conditions to safe harbor treatment are as follows: • The present value of the nonforfeitable accrued benefit, as determined under Code section 411(a)(11), must not exceed the maximum amount under Code section 401(a)(31)(B); • The mandatory distribution must be to an individual retirement plan within the meaning of Code section 7701(a)(37); 1 Section 657 of EGTRRA amended section 401(a)(31) of the Code to generally require the direct transfer of certain mandatory distributions from qualified plans to designated individual retirement plans, and directed the Department to issue regulations providing safe harbors under which (1) the plan administrator's designation of an institution to receive the automatic rollover, and (2) the initial investment choice for the funds would be deemed to satisfy the fiduciary responsibility provisions of section 404(a) of ERISA. The Department published a request for information concerning automatic rollovers in January 2003. See Institute Memorandum to Pension Committee No. 1-03 and Pension Operations Committee No. 1-03 [15520], dated January 7, 2003. The Institute filed a letter in response to the request for information in March 2003. See Institute Memorandum to Pension Members No. 12-03 and Pension Operations Advisory Committee No. 15-03 [15741], dated March 12, 2003. 2 A copy of the proposed regulation is available at the Federal Register website at <http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/2004/pdf/04-4551.pdf>. 2 • The mandatory distribution must (1) be invested in an investment product designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity and taking into account fees and expenses as discussed below, (2) be offered by a state or federally regulated financial

institution, and (3) seek to maintain a stable dollar value equal to the amount invested;<sup>3</sup> • Fees and expenses attendant to the IRA, including investments, such as establishment charges, maintenance fees, and investment expenses, must not exceed the fees and expenses charged by the provider for comparable rollover IRAs that do not receive automatic rollovers, and may be charged only against the income earned by the IRA (with the exception of charges assessed for the establishment of the IRA); • Participants must be furnished a summary plan description or summary of material modifications that describes the plan's automatic rollover provisions; and • The fiduciary's selection of the IRA and the investment of funds must not result in a prohibited transaction under section 406 of ERISA (unless exempted by a prohibited transaction exemption). In connection with the final condition, the Department has issued a proposed prohibited transaction exemption that would permit a fiduciary of a plan who is also the employer maintaining the plan to establish, on behalf of its separated employees, an IRA at a financial institution that is the employer or an affiliate, in connection with automatic rollovers.<sup>4</sup> The proposal would also permit a plan fiduciary to select a proprietary product as the initial investment for the IRA, and to receive certain fees in connection with the establishment or maintenance of the IRA and the investment of the mandatory distribution. The preamble to the proposed regulation also discusses issues raised by the Institute and others concerning certain requirements imposed upon IRAs and financial institutions under the Internal Revenue Code and the USA PATRIOT Act. With regard to Code requirements, the preamble states that the IRS and the Treasury Department have informed the Labor Department that they expect to issue guidance regarding the application of these rules to automatic rollovers in advance of, or simultaneously with, the issuance of a final safe harbor regulation. The preamble also notes that January 2004 guidance under the PATRIOT Act provides that the customer identification and verification (CIP) requirements of section 326 of the Act apply in this context only at the time the former participant or beneficiary first contacts the institution to

<sup>3</sup> The preamble to the proposed regulation states that the safe harbor investment products would typically include money market funds, interest-bearing savings accounts and certificates of deposit, and "stable value products" that are fully benefit responsive to the individual retirement plan account holder and provide a liquidity guarantee. 69 Fed. Reg. 9902. <sup>4</sup> A copy of the proposed prohibited transaction exemption is available at the Federal Register website at <http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/2004/pdf/04-4552.pdf>. <sup>5</sup> assert ownership or exercise control over the account, and not at the time of the establishment of the account by the employee benefit plan.

Finally, the preamble to the proposed safe harbor regulation states that the Department proposes to make the final regulation effective six months after the date of its publication in the Federal Register. Kathy D. Ireland Senior Associate Counsel <sup>5</sup> See Institute Memorandum to Pension Members No. 1-04 [16961], dated January 12, 2004.