The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 35609

February 1, 2024

DOL Issues Proposed Regulation to Implement SECURE 2.0 Automatic Portability Statutory Exemption

[35609]

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TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension RE: DOL Issues Proposed Regulation to Implement SECURE 2.0 Automatic Portability Statutory Exemption

On January 18, 2024, the Department of Labor (DOL) released proposed regulations to implement section 120 of the SECURE 2.0 Act,[1] which provides a statutory exemption for certain automatic portability transactions.[2] The statutory exemption allows for the receipt of fees and compensation by an automatic portability provider (APP) for services provided in connection with an automatic portability transaction.

In a statement of support of the automatic portability concept, DOL states that "[w]ith the proliferation of [defined contribution plan] accounts, there is a particular need for this type of automatic portability solution to help ensure participants remain connected to their retirement savings when they change jobs."[3]

Comments on the proposed regulations are due March 29, 2024.

Background

"Auto-portability" is designed to facilitate the consolidation of small accounts in plans and IRAs when individuals change jobs. When a retirement plan participant terminates employment with a vested benefit of $7,000 or less, the plan can automatically roll over their account to an IRA (a "Default IRA" or "Safe Harbor IRA"), if the participant does not take action after receiving the required notices.[4]

Auto-portability transactions involve searching and matching Default IRA owners with any plan account sponsored by the individual's new employer and, when a match is found, automatically transferring their account from the Default IRA into the new employer's plan. Auto-portability transactions therefore involve three separate components: (1) a "transfer-out" plan makes a mandatory distribution; (2) a Default IRA is established to receive the distributed funds; and (3) a "transfer-in" plan receives the account through a rollover from

the Default IRA when an IRA owner is matched with an account in an eligible employer-sponsored plan at a new employer.

In 2018, DOL issued guidance regarding an "auto-portability" program offered by the firm Retirement Clearinghouse (RCH). In an advisory opinion, DOL described the fiduciary status of RCH and plan sponsors when they take certain actions regarding the RCH program.[5] DOL also proposed an individual exemption from ERISA's prohibited transaction rules (finalized in 2019[6]) which allows RCH to receive fees under the program, provided certain conditions are met. DOL limited the exemption relief to a five-year term, which expires on July 31, 2024.

RCH subsequently collaborated with several retirement plan recordkeepers to create a consortium of recordkeepers—Portability Services Network, LLC (PSN). PSN is described as an independent entity which utilizes the RCH technology to build a nationwide, digital hub connecting recordkeepers and their plan sponsor clients that elect the auto-portability service.[7] Once recordkeepers join, they offer the auto-portability program to the plan sponsors they service.

Section 120 of the SECURE 2.0 Act created a new statutory exemption that "largely mirrors," according to DOL, the relief it granted to RCH in 2019. However, unlike an individual exemption, the statutory exemption is available to any service provider offering auto-portability services that meet the requirements.[8] The statutory exemption includes several conditions for relief, including acknowledgement of fiduciary status, reasonable fees, and various required notices and disclosures.

Section 120(c) of the SECURE 2.0 Act directs DOL to issue such guidance or regulations "as may be necessary" to carry out the purposes of section 120 (including a list a several specific consumer protections that DOL may address by regulation) not later than 12 months after the date of enactment (December 29, 2022). In letters to DOL regarding the need for guidance on SECURE 2.0 Act items, some organizations have suggested that further guidance from the DOL on section 120 is not necessary. In response to these comments, DOL explains that it believes regulations are needed to address and reinforce consumer protections, and to provide affected entities with an opportunity to comment on the proposal (including to opine on whether implementing regulations are necessary).[9]

Effective Date and Interim Interpretive Policy

DOL proposes that the final rule would be effective 60 days after publication in the Federal Register and that the requirements of the final rule would have prospective applicability. The statutory exemption is effective for transactions occurring on or after 12 months after December 29, 2022, and DOL makes clear that the statutory exemption is currently available for use. For the period of time between January 29, 2024 until DOL issues a final rule or other guidance, APPs and plan fiduciaries must use "a good faith reasonable interpretation of the law taking into account the list of consumer protection conditions and requirements in section 120(c) of the SECURE 2.0 Act" and must "act in a manner that furthers the financial interests of the affected plan, plan participant, or IRA owner[.]"[10]

DOL asks for comment on whether the final rule should have a delayed applicability date to allow time for APPs and plan fiduciaries to make any necessary changes to the programs or related contracts or arrangements to comply with the final rule. DOL also requests comments regarding how to approach the first annual audit required by the statutory exemption. Noting that a final rule will likely be issued part way through the first audit period, DOL asks about alternatives, such as allowing the first annual audit report to be

delayed and submitted together with the second annual audit report. DOL asks whether any other aspects of the proposal that would be subject to audit review should have a delayed effective date.

Proposed Regulation

The proposal generally tracks the requirements of the statutory exemption (which mirrors existing PTE 2019-02), and in many instances, proposes to include new, additional requirements.

Scope of Prohibited Transaction Relief (Section (a))

The proposal confirms the narrow scope of the exemptive relief, covering (1) the receipt of fees and compensation by an APP for services provided in connection with an auto-portability transaction, and (2) the receipt of a fee by an APP from an employer-sponsored retirement plan sponsor in lieu of a fee imposed on an IRA owner, provided that the conditions of the exemption are met. In applying this standard, services will not be considered "provided in connection with an automatic portability transaction" if they would have been provided in the absence of an auto-portability transaction or anticipation of a future auto-portability transaction.

Acknowledgment of Fiduciary Status (Section (b)(1))

The statutory exemption requires that an APP acknowledge in writing that the APP is a fiduciary with respect to the IRA in an auto-portability transaction.[11]

The proposal describes the time and format of the required acknowledgement, requiring an acknowledgement in writing upon being engaged by a plan fiduciary and in the notices and disclosures required by the proposal.

Fees (Section (b)(2))

The statutory exemption provides that the fees and compensation received, directly or indirectly, by the APP for services in connection with an auto-portability transaction, may not exceed reasonable compensation and must be fully disclosed in writing in advance of the transaction and approved by a plan fiduciary.[12] The statute prohibits an APP from receiving any fees or compensation in connection with an auto-portability transaction involving a plan sponsored or maintained by the APP.

The proposal incorporates the statutory provision, incorporates the regulatory standard under the Code regarding reasonable compensation for the provision of services,[13] and requires that the fee disclosure include the information required to be disclosed under DOL's regulation regarding fee disclosure from plan service providers to plan fiduciaries (the APP will be considered to be a "covered service provider" providing services as a fiduciary and as a recordkeeper).[14] The proposal expands the prohibition on receiving fees related to a plan sponsored by the APP to also extend to any plans maintained by any of the APP's affiliates.[15]

The proposal would also prohibit the receipt or payment of third-party compensation by an APP (including its affiliates) in connection with an auto-portability transaction.[16] However, an APP would be permitted to share a portion of its fee with another APP, as long as the overall fee does not increase, compared to the fees disclosed to the plan administrator and IRA owner. Further, a plan sponsor may pay a fee that is in lieu of a fee imposed on an IRA

owner. The restriction on third-party payments does not prevent an APP from receiving fees for services that are in addition to services provided in connection with the execution of auto-portability transactions.

Data Usage and Protection (Section (b)(3))

The statutory exemption prohibits an APP from marketing or selling data relating to the IRA or to the participants of the plan.[17]

The proposal incorporates this prohibition and further provides that an APP must take "all necessary steps that a reasonable fiduciary would take" to safeguard participant IRA data, to the extent it exercises control over the data. The proposal requires that if data is improperly accessed, the APP must take appropriate remedial actions. DOL requests comments on whether it should include specific data security requirements, such as a requirement that the APP purchase insurance that would cover data breaches.

Open Participation (Section (b)(4))

The statutory exemption requires that the APP offer auto-portability transactions on the same terms to any transfer-in plan.[18]

DOL proposes to further require that "open participation" would mean that the APP may not restrict or limit the ability of an employer-sponsored plan, IRA provider, or recordkeeper to engage other APPs to execute auto-portability transactions.

Notices to DOL, Plans, and IRA Owners (Section (b)(5))

DOL proposes to require that the APP must notify DOL within 90 days of it beginning to operate an auto-portability transaction program that is intended to rely on the exemptive relief. The reporting must include the name of each business entity relying on the exemption.[19]

DOL believes that under its existing rules regarding the required content for summary plan descriptions (SPD) provided to plans participants, participating transfer-out plans and transfer-in plans must include a description of the auto-portability program in the plan's SPD (or in a summary of material modifications (SMM) sent to participants).[20] DOL proposes to require that the APP provide each plan administrator with a model description of the auto-portability program, including applicable fees and expenses under the program, that could be used by the plan to fulfill its SPD obligations, along with a notice that alerts the plan of the requirement to describe the program and fees in the SPD. DOL requests comments on whether the final rule should include specific content requirements for the notice.

Notices to IRA Owners

The statutory exemption requires the APP to provide two notices to IRA owners—a pre-transaction notice (provided at least 60 days in advance of the transaction) and post-transaction notice (not later than 3 business days after the transaction).[21]

DOL proposes to also require a third notice—an initial enrollment notice—to the IRA owner no later than 15 days after the IRA is enrolled in an arrangement that includes an auto-portability transaction component. This notice must include information regarding the nature of the auto-portability transaction and additional aspects of the IRA arrangement.

DOL suggest that this notice could be combined with the notice that is currently required upon the establishment of a Default IRA.[22]

DOL incorporates the statutory exemption's requirements regarding the pre-transaction notice and proposes adding a clarification that the notice cannot be sent earlier than 90 days in advance of the transaction. DOL incorporates the statutory exemption's requirements regarding the post-transaction notice, including what it describes as "minor clarifying language."

To the extent that the APP has been engaged by the plan to provide notices to participants in connection with mandatory distributions, DOL specifies that the proposed notices could be consolidated with other disclosures.

The statutory exemption requires that the pre-transaction notice and post-transaction notice be written in a manner calculated to be understood by the average person and shall not include inaccurate or misleading statements.[23] The proposal includes several clarifications of this requirement, including that the APP must take into account such factors as the level of comprehension and education of the typical intended recipient and the complexity of the terms of the program. DOL further proposes to require "culturally and linguistically appropriate standards," requiring, for example, that if the address of a notice recipient is in a county where ten percent or more of the population is literate only in the same non-English language, the notice or disclosure must include a prominent statement in the relevant non-English language about the availability of language services. According to the preamble, this is essentially the ACA standard for group health benefit notices,[24] however this appears to be the first time DOL has applied this standard in the retirement context.

Regarding the delivery of notices to IRA owners, DOL proposes requiring the APP to adopt policies and procedures to ensure that it has current and accurate data on participants and IRA owners.[25] The proposal further would require that notices and disclosures to participants and IRA owners must be made under ERISA's disclosure obligation general standard that materials shall be furnished using "measures reasonably calculated to ensure actual receipt of the material by plan participants, beneficiaries and other specified individuals."[26] DOL requests comments on how undeliverable mail should be handled and whether additional protections are needed in the case of returned mail. DOL also requests comments on whether it should specifically address electronic delivery, including how undeliverable electronic notices should be handled.

Frequency of Searches (Section (b)(6))

The statutory exemption requires that the APP query on at least a monthly basis whether any individual with a Default IRA has an account in a transfer-in plan.[27]

To verify the accuracy of individuals' information to ensure that matches are correct, the proposal would require several verification steps to be performed at least twice in the first year the APP holds an account and annually thereafter. These include ongoing participant address validation searches via automated checks of (i) National Change of Address records, (ii) two separate commercial locator databases, and (iii) any internal databases maintained by the APP. If these methods do not result in a valid address, the proposal would require the APP to perform a manual internet-based search.

DOL requests comments on whether additional or different verification steps should be

required and whether partnering recordkeepers should be permitted to run the queries.

Monitoring Transfers into an Employer-Sponsored Retirement Plan (Section (b)(7))

DOL proposes to include a monitoring requirement. The APP would be required to ensure that each transfer-in plan designate a plan official responsible for monitoring transfers into the plan and confirming that amounts received on behalf of a participant are invested properly.[28]

Timeliness of Automatic Portability Transaction Execution (Section (b)(8))

The statutory exemption provides that, after liquidating the assets of a Default IRA, an APP shall transfer the account balance of such IRA as soon as practicable.[29]

DOL proposes to require that the APP must follow timeframes formally established in policies and procedures. DOL asks for comments regarding whether the final rule should include a specific timeframe or other clarification of the "as soon as practicable" standard.

Limitation on Exercise of Discretion and Policies and Procedures (Section (b)(9))

The statutory exemption provides that the APP cannot have discretion to affect the timing or amount of the transfer pursuant to an auto-portability transaction other than to deduct the appropriate fees.[30]

The proposal expands on this requirement by specifying that an APP will be deemed to satisfy this requirement if it "establishes, maintains, and follows policies and procedures regarding the process for executing automatic portability transactions." The proposal lists several items that the policies and procedures must "specifically and prudently" address.

Audit and Corrections (Section (c))

The statutory exemption requires that an APP conduct an annual audit, in accordance with regulations issued by DOL, to demonstrate compliance with the Code and regulations thereunder and to identify any instance of noncompliance. The APP must submit the audit annually to DOL, in the form and manner specified by DOL.[31]

DOL proposes that the audit be an independently conducted audit.[32] The proposal would require a written audit report that includes the following:

1) the number of completed auto-portability transactions during the audit period;

2) whether the required notices met the timing and content requirements of these regulations;

3) whether the required notices were written and delivered in a manner reasonably designed to ensure that affected individuals would both receive and understand the notices;

4) whether any required notices were returned as undeliverable and what steps were taken by the APP to address undeliverable notices;

5) whether the appropriate transfer-in plan accounts received all the assets due as a result of the auto-portability transactions;

6) a summary of all fees charged by the APP (and any affiliates) for services in connection with auto-portability transactions, including whether those fees increased since the last report;

7) whether the fees and compensation received by the APP (including its affiliates) are consistent with the fees authorized by the appropriate fiduciaries and did not exceed reasonable compensation;

8) whether all requirements of [the statutory exemption] and these proposed regulations were satisfied with respect to: (a) the policies and procedures and (b) the transactions and disclosures that were reviewed;

9) a summary of compliance issues reported to or discovered by the auditor, the auditor's recommendations, and the extent to which the APP has addressed or is addressing the issues pursuant to the correction procedures;

10) any other recommendations from the auditor to improve the policies and procedures and overall execution of auto-portability transactions; and

11) a description of the auditor's audit methodology.

To assist DOL with its required report to Congress,[33] DOL proposes that the written audit report would also include:

1) the number of automatic rollovers of mandatory distributions from qualified plans into Default IRAs that are included in the auto-portability program;

2) the number of completed auto-portability transactions; and

3) the number of Default IRAs separately in each of the following categories: (a) which have been transferred to designated beneficiaries, (b) for which the APP is searching for next of kin due to a deceased IRA owner without a designated beneficiary, and (c) that were reduced to a zero balance while in the APP's custody.

DOL proposes to require the independent auditor to complete the audit within 180 days after the audit period, and that the APP must submit the written audit report to DOL (along with a certification, under penalty of perjury, of the accuracy of the report) within 30 days of completion.

DOL proposes to allow three components for corrections, in the event noncompliance is found. These include self-correction by the APP, correction of noncompliance found by the auditor (which must be identified in the audit report), and in the event of significant compliance issues,[34] DOL-required supplemental audits and corrective actions.

Automatic Portability Provider Website (Section (d))

The statutory exemption requires the APP to maintain a website which contains (1) a list of recordkeepers with respect to which the APP carries out auto-portability transactions and (2) a list of all fees paid to the APP.[35]

DOL proposes that the list of fees paid must include the identity of the party or account paying the particular fee, and that the website include the number of plans and participants covered by each recordkeeper. DOL asks for comments on what other materials should be

required to be posted on the website, such as a copy of the independent auditor's audit report.

Limitations on Exculpatory Provisions (Section (e))

Under the proposal, the APP would be prohibited from including in its contracts exculpatory provisions that disclaim or limit the APP's liability in the event of an improper roll-in to the transfer-in plan.[36] DOL requests comments on whether this prohibition on exculpatory provisions should be broader.

Record Retention (Section (f))

The statutory exemption requires an APP to maintain, for at least six years, records sufficient to demonstrate compliance with the statutory exemption and to make such records available to staff of DOL and Treasury within 30 days of written request.[37]

The proposal provides that the failure to maintain the necessary records (other than where records are lost of destroyed due to circumstances beyond the control of the APP) will result in the loss of the exemptive relief, with respect to the transactions for which such records are missing.

Request for Comments

Comments on the proposed regulations are due March 29, 2024. In addition to several questions posed throughout the preamble, DOL specifically requests comments on the following two issues.[38]

- Whether the rule should include provisions that address issues related to IRA beneficiaries (for example, whether funds for a beneficiary could be moved from a Default IRA to an employer-sponsored plan in which the beneficiary participates).
- Whether DOL should extend the exemptive relief to transactions involving rollovers of mandatory distributions with a value of $1,000 or less. Under a strict reading of the statute, the relief only applies with respect to Default IRAs from mandatory distributions of account exceeding $1,000 and not exceeding $7,000 (because mandatory distributions of amounts of $1,000 are permitted to be cashed out rather rolled over into a Default IRA). Under DOL's 2004 rules implementing rollovers to Default IRAs, DOL expressly permitted amounts of $1,000 or less to be rolled over into a Default IRA.[39]

Shannon Salinas
Associate General Counsel - Retirement Policy

Notes

[1] For an overview of the SECURE 2.0 Act, see ICI Memorandum No. 34795, dated January 12, 2023, available at https://www.ici.org/memo34795.

[2] The proposal was published at 89 Fed. Reg. 5624 (January 29, 2024), available at https://www.govinfo.gov/content/pkg/FR-2024-01-29/pdf/2024-01208.pdf. DOL's press release is available at https://www.dol.gov/newsroom/releases/ebsa/ebsa20240118.

[3] 89 Fed. Reg. at 5624. Also see quote from Assistant Secretary Lisa M. Gomez, included in DOL's press release.

[4] Section 304 of the SECURE 2.0 Act raised the cash-out limit from $5,000 to $7,000, effective for distributions made after December 31, 2023. For purposes of calculating the account balance for this purpose, plans are permitted to disregard amounts the participant rolled over into the plan. Accounts of $1,000 are permitted to be cashed out by mailing a check to the participant, rather than rolling the amount into a Default IRA.

[5] For background on the auto-portability program and associated DOL guidance, see ICI Memorandum No. 31510, dated November 30, 2018, available at https://www.ici.org/memo31510.

[6] The final prohibited transaction exemption (PTE) 2019-02 was published at 84 Fed. Reg. 37337 (July 31, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-07-31/pdf/2019-16237.pdf.

[7] See RCH news release dated October 5, 2022, available at https://rch1.com/news/press-release-americas-leading-401k-providers-and-retirement-clearinghouse-collaborate-to-implement-a-nationwide-network-for-auto-portability. Several ICI members are PSN member recordkeepers.

[8] At least one other firm has announced that it has developed an auto-portability service. See press release, dated July 6, 2023, available at https://www.newswire.com/news/testing-begins-on-millennium-trusts-new-open-portability-network-22077955.

[9] 89 Fed. Reg. at 5627.

[10] 89 Fed. Reg. at 5627.

[11] Code section 4975(f)(12)(B)(i).

[12] Code section 4975(f)(12)(B)(ii).

[13] 26 CFR 54.4975-6(e).

[14] 29 CFR 2550.408b-2(c). Section 120(c)(2) of the SECURE 2.0 Act specifically authorizes DOL to issue guidance requiring that the APP disclose this information.

[15] Section (g)(1) of the proposal defines affiliate as a person or entity who, directly or indirectly (through one or more intermediaries "controls, is controlled by, or is under common control with such person or entity; or is an officer, director, or employee of, or partner in, such person or entity."

[16] Section 120(c)(5) authorizes DOL to include such a restriction.

[17] Code section 4975(f)(12)(B)(iii).

[18] Code section 4975(f)(12)(B)(iv).

[19] This notification is not required by the statute.

[20] DOL notes that its 2004 regulatory safe harbor for automatic rollovers to Default IRAs

require plan administrators to provide participants with an SPD or SMM that describes the plan's automatic rollover provisions. 29 CFR § 2550.404a-2(c)(4). Further, Section 120(c)(3) authorizes DOL to require plans to fully disclose fees related to an auto-portability transaction in its SPD or in an SMM.

[21] Code sections 4975(f)(12)(B)(v) and (vi).

[22] Code section 401(a)(31)(B).

[23] Code section 4975(f)(12)(vii).

[24] 89 Fed. Reg. at 5632.

[25] Section 120(c)(10) of the SECURE 2.0 Act specifically authorizes DOL to issues rules to ensure that the appropriate participants and beneficiaries, in fact, receive all the required notices and disclosures.

[26] 29 CFR 2520.104b-1(b).

[27] Code section 4975(f)(12)(B)(viii).

[28] The statutory exemption does not include this requirement; DOL proposes it pursuant to the general regulatory authority provided by section 120(c) of the SECURE 2.0 Act.

[29] Code section 4975(f)(12)(B)(ix).

[30] Code section 4975(f)(12)(B)(x).

[31] Code section 4975(f)(12)(B)(xi).

[32] An auditor will be considered independent if: (1) the auditor is a person or an entity that the APP does not own or control, and (2) the auditor does not derive more than two percent of its annual revenue from services provided directly or indirectly to the APP or any of its affiliates. DOL requests comments regarding whether a threshold higher than two percent should be permitted and what additional protections commenters would propose to support higher thresholds.

[33] Section 120(d) of the SECURE 2.0 Act requires that DOL provide a report to Congress, including several specified items, beginning two years after the first audit report from an APP received by DOL and every three years thereafter.

[34] The scenarios listed are similar to provisions in DOL's amendment to PTE 84-14 (the QPAM exemption) and DOL's final amendments to the procedures governing PTE applications, and include:

(1) engaging in a systematic pattern or practice of violating any provision of the statutory exemption or an implementing regulation;

(2) intentionally violating any provision of the statutory exemption or an implementing regulation;

(3) providing materially misleading information to DOL, Treasury, or the auditor in connection with auto- portability transactions;

(4) a foreign or domestic criminal conviction involving or arising out of the conduct of the auto-portability program or any auto-portability transaction; or

(5) a foreign (or foreign equivalent) or domestic criminal conviction for any felony involving the following crimes: larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, misappropriation of funds or securities, or conspiracy to commit any such crimes or a crime in which any of the foregoing crimes is an element. Section (c)(10) of the proposal.

For a summary of the proposed amendments to the QPAM Exemption, see ICI Memorandum No. 34239, dated August 3, 2022, available at https://www.ici.org/memo34239.

[35] Code section 4975(f)(12)(B)(xii).

[36] Section 120(c)(6) of the SECURE 2.0 Act specifically authorizes DOL to prohibit such exculpatory provisions.

[37] Code section 4975(f)(12)(B)(xi)(I).

[38] 89 Fed. Reg. at 5636.

[39] 69 Fed. Reg. 58018, at 58019 (September 28, 2004), available at https://www.govinfo.gov/content/pkg/FR-2004-09-28/pdf/04-21591.pdf ("Taking into account the purpose and provisions of the safe harbor regulation, the Department is persuaded that application of the safe harbor to rollovers of mandatory distributions of $1,000 or less is appropriate. In this regard, the Department believes that the availability of the safe harbor for such distributions may increase the likelihood that such amounts will be rolled over to individual retirement plans and thereby may promote the preservation of retirement assets, without compromising the interests of the participants on whose behalf such rollovers are made.")
