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AUTOMATIC ROLLOVERS: DOL PROPOSES SAFE HARBOR

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), qualified pension plans that include cash-out rules for benefits of \$5,000 or less must provide for automatic rollover, once regulations have been issued. Plan sponsors have been waiting for the rules. The DOL has taken the first step with its proposed regulations on a safe harbor for fiduciary responsibility. If adopted soon, plans could be required to implement automatic rollovers by late 2004 or early 2005.

Under Code section 401(a)(31)(B), a direct transfer rollover is required automatically if a plan provides for immediate distribution of benefits of \$5,000 or less, the participant does not make a rollover election, and the benefit is at least \$1,000. The rollover is to be made to an individual retirement plan or annuity (IRA). This provision applies to all pension, profit sharing, 401(k) and other qualified plans with the mandatory small benefit cash-out provision. Benefits under \$1,000 can still be cashed out by distribution of a check to the participant. Automatic rollovers could be more than \$5,000 if a plan provides that the determination of eligibility for the small benefit cash-out is made without taking into account any amounts previously rolled over into the plan.

To establish an automatic rollover, the plan will need to work with one or more IRA providers and will need to revise its notice and election forms for cash-outs to advise the participant of the consequences of failing to direct a rollover of the cash-out benefit. The DOL proposed regulations would provide a "safe harbor" for plan fiduciaries. If the regulations were followed, plan fiduciaries would be deemed to have complied with their basic fiduciary duties under ERISA section 404(a). The DOL would allow automatic rollovers to be established outside the "safe harbor" but the plan fiduciaries would be responsible for their fiduciary compliance.

Safe Harbor Steps

Under the proposed regulations, plan fiduciaries will have satisfied their ERISA fiduciary responsibility if the following six "conditions" are met when distributing an automatic rollover:

1. Amount. The amount of the rollover distribution must be more than \$1,000 but less than the maximum cash-out under the plan's mandatory cash-out provision, currently \$5,000. A participant's prior rollover contribution may be disregarded for the purposes of determining the maximum cash-out amount. As a result, a cash-out distribution may exceed \$5,000 if it includes a prior rollover.
2. Account. The rollover must be directed to an IRA account. The IRA provider would typically be a bank, insurance company, financial institution, or other provider authorized to be an IRA trustee or custodian. The plan fiduciary is not required to consider the financial stability of the provider.
3. Investment. The rollover must be invested in a product designed to preserve principal and to provide a reasonable rate of return, whether or not guaranteed, consistent with maintaining liquidity. Consideration of fees and expenses must be included. The investment product must be offered by a state or federally regulated financial institution and must be designed "to maintain a stable dollar value equal to the amount invested." Safe harbor investments would typically include savings accounts, money market accounts, certificates of deposit, and certain stable value products. The DOL preamble to these proposed regulations notes that these investment products should not include "substantial restrictions to the account holder's access to the assets" held by the IRA. The Plan could designate the initial investment in the rollover account.

4. **Fees.** The IRA provider must not charge fees and expenses that exceed those that it charges for comparable IRAs established for voluntary rollover distributions. Any fees and expenses, other than those charged to establish the IRA, may be charged against the account, but may not exceed, the income earned on the rollover amount. "Fees and expenses" include maintenance fees, investment expenses, termination costs and surrender charges. Establishment fees may be charged against the rollover amount. Query if plan sponsors will consider paying some or all of establishment fees from employer general assets to facilitate automatic rollovers if normal fees are disproportionate to the rollover amounts.
5. **Disclosure.** Plan sponsors must disclose the automatic rollover provisions to participants in a summary plan description ("SPD") or a summary of material modifications ("SMM") in advance of the automatic rollover. The disclosure must explain the type of investment, identify the IRA provider, describe the allocation of fees and expenses, and identify a plan contact for obtaining further information. The statute also requires the plan to disclose, in a separate writing or in the required rollover notice under Code Section 402(f), that the participant may transfer the automatic rollover to another IRA of the participant's choosing.
6. **No Prohibited Transaction.** The fiduciary must choose an IRA provider and investment fund that will not result in a prohibited transaction. A prohibited transaction could occur if the plan fiduciary chooses a provider or investment that is affiliated. The DOL has also proposed a Prohibited Transaction Class Exemption ("PTCE") for plans maintained by IRA providers, such as a bank, insurance company, credit union or mutual fund company. According to the PTCE, a financial institution may select itself, or an affiliate, to serve as the IRA provider for automatic rollovers from its own plan and/or to select proprietary investment products. The investments products must be offered by a FDIC-insured bank or savings association, a federally insured credit union, an insurance company product subject to state guarantee associations, or a mutual fund registered under the federal Investment Company Act. The IRA may not pay a sales commission for the proprietary investment product but may accept related fees that meet certain requirements.

Effective Date

No action is required by Plan sponsors at this time; the DOL is currently seeking comments on the proposed regulations. The DOL is proposing to make the final safe harbor regulation effective six months after the date of publication of the final regulation in the Federal Register in order to afford plan fiduciaries adequate time to meet the rollover safe harbor requirements. When the proposed regulations become final, Plan sponsors will need to act quickly to choose automatic rollover providers, amend plan documents and forms and provide new SPDs, SMMs and notices.

If you have questions about qualified pension or profit sharing or 401(k) plans' compliance with the mandatory rollover rules, please contact the Seyfarth Shaw Employee Benefits Group attorney with whom you work or any employee benefits attorney listed on the website at www.seyfarth.com.

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