ASPPA
WORKING FOR AMERICA'S RETIREMENT

Fiduciary Responsibility Under the Employee Retirement Income Security Act of 1974 Automatic Rollover Safe Harbor

Comments to the Department of the Labor Employee Benefits Security Administration

29 CFR Part 2550

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4245 N. Fairfax Dr., Suite 750
Arlington, VA 22203
Phone 703.516.9300
Fax (703) 516-9308
www.aspa.org

The American Society of Pension Actuaries (ASPPA) and its members welcome the March 2, 2004, publication of proposed regulations (Proposal) relating to the formation and initial investment selection of automatic rollovers that would be deemed to satisfy the fiduciary responsibility provisions of Section 404(a) of the Employee Retirement Income Security Act of 1974, as amended (ERISA). These automatic rollover rules were initiated under Section 657(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

ASPPA is a national organization of more than 5,000 members who provide actuarial, consulting, administrative, legal and other services to qualified retirement plans.

ASPPA respectfully submits comments on the following topics in relation to the Proposal:

1. The amount of mandatory distributions that is eligible for the safe harbor fiduciary treatment;
2. Required disclosures to participants and beneficiaries;
3. Permissible fees and expenses charged by IRAs to which automatic rollovers are made;
4. The ability of companies and individuals in the securities and banking industry to provide these accounts in light of regulation relating to those industries, such as the "suitability" obligations of brokers; and
5. Proposed effective date for the changes.

I. The Amount of Mandatory Distributions

Section §2550.404a–2(a)(1) of the Proposal provides that the proposed safe harbor applies only to the automatic rollover of a mandatory distribution described in Section 401(a)(31)(B) of the Internal Revenue Code (Code) (distributions in excess of $1,000, but less than or equal to $5,000). The Proposal notes that this is consistent with Congress' mandate in Section 657(c)(2) of EGTRRA.

The automatic rollover rules establish a mechanism under which the trustee may move money from the plan to an individual retirement account (IRA) on behalf of a participant who is nonresponsive to requests for direction about a balance in the retirement plan that may be automatically cashed out by the trustee. This automatic cash-out is tied to the rules under Code Section 411(a)(11)(A) and Section 205(g) of ERISA. This new mechanism is expected to be the basis for handling other situations in which automatic cash-outs of benefits are permitted, when the amount at issue is either less or more than the amount defined in Code Section 401(a)(31)(B). For example, such distributions could occur in connection with the termination of a profit sharing plan under Treas. Reg. §1.411(a)-11(e)(1), as well as distributions made after the later of normal retirement age or age 62 pursuant to Treas. Reg. §1.411(a)-11(c)(4). In those circumstances, the amount of the cash-out could exceed the maximum outlined in Code Section 401(a)(31)(B). Furthermore, an employer may want to engage in an automatic rollover of all accounts, even those containing less than $1,000 (particularly when that low account balance is coupled with a significant rollover account that is disregarded for determining the amount of the cash-out). This decision could be made out of an employer's belief that any retirement money should be preserved for retirement, or because the employer seeks to have a consistent procedure for cash-outs, regardless of the amount. A plan sponsor also may want to provide for an automatic rollover of accounts containing less than $1,000 to have a mechanism for handling small accounts of missing participants.

Although these alternate types of cash-outs are common, the Department of Labor (Department) elected in the Proposal not to extend to the plan fiduciaries making them the same safe harbor available for the Section 401(a)(31)(B) cash-outs. While the Department was not mandated by Congress to broaden the safe harbor, ASPPA respectfully notes that it is within Department's regulatory authority to do so. ASPPA requests that the Department extend the fiduciary safe harbor to these other types of cash-outs for several reasons:

- Without this extension of the safe harbor, plan fiduciaries engaging in these other cash-outs are subject to different types of scrutiny and standards than are those engaging in the cash-outs covered by Section 401(a)(31)(B). However, the circumstances of the two types of cash-outs are so similar from the participants' perspective that a variance in fiduciary standards is not warranted.

- Because the automatic cash-outs under Section 401(a)(31)(B) may contain rollover accounts and, therefore, exceed $5,000, the size of the accounts in the alternate cash-outs is not necessarily any different than those under the Section 401(a)(31)(B) cash-outs.

- There is no alternative guidance available for plan fiduciaries that are engaging in the automatic cash-outs that do not fall within the ambit of Section 401(a)(31)(B). Therefore, it is likely that fiduciaries faced with these types of cash-outs will have no other choice but to rely on the safe harbor for guidance. It is not appropriate to except these types of distributions from the protection of the safe harbor without providing other guidance to fiduciaries in this circumstance.

ASPPA Recommendation

ASPPA recommends that the Department reconsider its position in the Proposal and extend the safe harbor rules for cash-outs of all sizes.

ASPPA understands the Department's concern that the Congressional mandate in EGTRRA applies only to required distributions of between $1,000 and $5,000. Nonetheless, the proposed regulations represent an appropriate and reasoned interpretation of a fiduciary's duties under Section 404 of ERISA, which is clearly within the Department's normal rulemaking authority under Section 505 of ERISA.

II. Required Disclosures to Participants and Beneficiaries

Proposal Section 2550.404a-2(c)(5) conditions safe harbor relief on the furnishing of pertinent information to the plan's participants and beneficiaries via a summary plan description (SPD) or a summary of material modifications (SMM) in advance of an automatic rollover.

Code Section 401(a)(31)(B) requires the plan administrator to notify the participant in writing, either separately or as part of the notice required under Code Section 402(f) of the plan's procedures governing automatic rollovers.

ASPPA has significant concerns about the ability of plan sponsors to amend their plans to conform to the new automatic rollover rules, and to amend the SPD, or provide a SMM, prior to the effective date of these rules. A six-month lead time to engage in this documentation process is not sufficient for all plans that contain automatic cash-out language for amounts below $5,000. Furthermore, this is a departure from the normal SPD and SMM rules, which generally permit that participants receive these documents within 210 days following the end of the plan year in which a plan is amended. DOL Reg. §2520.104b. In addition to the fact that more time is needed to prepare these documents, the provision of amended SPDs or SMMs may be costly, requiring preparation, review, layout, printing, and distribution activities. Plan fiduciaries should not be required to expend those funds unexpectedly within such a short timeframe, possibly being required to pay a premium for "rush" service.

ASPPA understands that it is important for participants to receive information about the automatic rollover procedures before actions are taken to their accounts. Nonetheless, it is more reasonably achievable for most plan sponsors to provide this information to terminated participants [or participants entitled to a distribution as part of a modified Section 402(f) notice] during the period of time between the finalization of the regulations and the date on which the normal SPD and SMM amendment rules would apply.

ASPPA Recommendation

ASPPA urges the Department to permit plan sponsors to provide revised SPDs or SMMs within the normal Regulation §2520.104b timeframe for plan amendments. In the interim, plan sponsors should be permitted to notify affected participants of the automatic rollovers procedures in the revised 402(f) notice or other separate written notice.

Furthermore, the Department should work with the Internal Revenue Service to permit amendments of the relevant plan sections in due course; preferably by the time the employer's tax returns for the 2004 plan year are filed or by the end of the EGTRRA remedial amendment period. ASPPA sees no policy reason to require that the new rollover process be incorporated into a plan document prior to end of the normal remedial amendment period.

III. Permissible Fees and Expenses

Proposal Section 2550.404a-2(c)(4) provides that the fees and expenses charged to such plans may not exceed the fees and expenses charged by the provider for comparable individual retirement plans established for rollover distributions that are not subject to the automatic rollover provisions of Code §401(a)(31)(B).

The regulations also seek to protect the investment principal for the automatic rollover accounts by limiting the fees and expenses charged for maintenance of these accounts to the income earned by the account.

Although the Department's concerns about preserving principal and protecting participants' funds is understandable, it is inappropriate for the Department to limit fees in this manner. First, this type of limitation presupposes that these fees will be sufficient to enable the fundholder for the rollover IRA to properly account for and service these accounts. That is likely to be untrue, resulting in a chilling of the marketplace for these types of accounts. Second, while the fundholder is limited to the same set-up fees for the automatic rollover accounts as other accounts, it is prevented from charging comparable fees on an ongoing basis. This inconsistent treatment is unreasonable.

As discussed by some of the Request for Information (RFI) commenters, the marketplace will quickly determine the appropriate fees to be charged for the automatic rollover accounts, and such fees will be set by the fundholders based on a proper evaluation of their cost in providing these accounts to the public, their desired profit margins, and the existing market competition available. Fundholders that charge considerably more than others generally will fail to attract depositors. Fundholders that can provide the product cost-efficiently will be the recipients of the business. It is inappropriate and unnecessary for the Department to make such determinations.

Furthermore, if the current rules comparing the set-up fees charged for automatic rollover accounts to those for non-automatic rollover accounts are adopted, such comparison should be clarified to be between accounts of similar balances and investment types. All IRAs are not the same – some provide for significant market trading and participant self-direction of brokerage accounts, others are simply invested in money market accounts or certificates of deposit. The comparison of fees should be made among analogous accounts and balances.

ASPPA Recommendation

ASPPA recommends that the Department eliminate, or at least significantly modify, its rules regarding the fees that can be charged for the establishment of automatic rollover accounts. The Department should permit the marketplace to determine the appropriate fees for these accounts. Furthermore, if the current rule regarding comparing the fees charged for automatic rollovers to other IRA accounts remains, this comparison should be between the automatic rollovers and other IRAs with similar balances and investment types.

IV. Securities and Other Legal Considerations

As ASPPA discussed in its comments to the RFI, there are legal concerns affecting the ability of those who would provide these accounts to retirement plan fiduciaries and their participants. In particular, individuals that are licensed to market securities are required to offer only "suitable" products for those to whom they sell. Because these individuals would have no contact with the participant for whom the automatic rollover is being established, they would be unable to opine as to whether the account is or is not suitable for the participant. Similarly, banking and securities procedures relating to having a signatory on the account or a designated beneficiary may also make it difficult for the accounts to be offered.

It is critical to the success of the automatic rollover rules that plan fiduciaries have a market of service providers who can assist them in establishing these IRA accounts. If the providers are prevented by the ethics of their profession from doing so, the accounts cannot be made available.

ASPPA Recommendation

ASPPA recommends that the Department coordinate with the Securities and Exchange Commission to provide guidance to brokers to enable them to market these accounts to plan fiduciaries.

V. Effective Date of Regulation

ASPPA requests clarification on the effective date of the regulations, once finalized. Specifically, the Proposal states that the rules will become effective six months after the final regulation is published. However, it is unclear whether these final rules would apply to involuntary cash-out distributions made six months following the publication of the final rules, or to distributions in the plan year that begins at least six months after that date. ASPPA is particularly concerned about distributions for which the process is ongoing at the time of the finalization of the rules. For example, it is possible that a given participant would receive a distribution package and 402(f) notice prior to the effective date of the final rules, but receive a distribution after such effective date.

ASPPA Recommendation

ASPPA recommends that the rules be mandatorily applicable to distributions occurring in the plan year following six months after the publication of the final regulation. In addition, for those plan sponsors who are able to do so, ASPPA recommends that the Department permit the new rules to be applied at the plan sponsor's option for distributions that occur before that date. Finally, ASPPA recommends that the new rules apply only to distributions that are initiated after the effective date of the final regulations, and not to those for which the distribution process has already begun.

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These comments were prepared by ASPPA's Department of Labor subcommittee and 401(k) subcommittee of the Government Affairs Committee, primarily authored by Mark Clark, QPA and Martin M. Heming, Esq., APM. Please contact us if you have any comments or questions regarding the matters discussed above.

Sincerely,

Sherwin Kaplan, Esq., APM, Chair DOL subcommittee	Brian H. Graff, Esq. Executive Director
Fred Singerman, Esq., Chair DOL subcommittee	Sal L. Tripodi, Esq., APM, Co-chair Gov't Affairs committee
Jeffrey C. Chang, Esq., APM, Co-chair Gov't Affairs committee	Ilene H. Ferenczy, Esq., Chair Administration Relations committee