



Dedicated to the Private Pension System

Comments to the
Department of Labor
Employee Benefits Security Administration

Federal Register
Vol. 68, No. 4
January 7, 2003
pp. 992-994

**Automatic Rollovers
From Qualified Plans to
Individual Retirement Accounts**
Proposed Rule

29 CFR Part 2550

May 15, 2003

4245 N Fairfax Drive, Suite 750
Arlington, VA 22203
Phone (703) 516-9300
Fax (703) 516-9308
www.aspa.org

RECEIVED
OFFICE OF REGULATIONS
AND INTERPRETATIONS

2003 MAY 19 PM 5:56

Automatic Rollovers from Qualified Plans to Individual Retirement Accounts

The American Society of Pension Actuaries (ASPA) offers these comments on the Proposed Rule relating to fiduciary responsibility in relation to automatic rollovers. ASPA and its members welcome the opportunity to provide input to the Department of Labor on this important issue.

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

It is critical to ASPA members and their plan sponsor clients that the automatic rollover rules are clear and easy to administer. ASPA is concerned that rules that are too complex, or that impose too much potential liability on plan fiduciaries, will place an unreasonable burden on plan sponsors, particularly small business plan sponsors. ASPA respectfully requests that the Department of Labor (Department) keep the need for simplicity and certainty in mind when drafting regulations for automatic rollovers.

SUMMARY OF ISSUES

These comments address the issues listed below and are described in greater detail in the "Discussion of Issues" section. Each discussion of an issue begins with general comments, proceeds to more specific issues, and is followed with ASPA's recommendation(s).

1. Post-establishment fiduciary liability of plan sponsors and other plan officials;
2. Inability to obtain accountholder's signature;
3. Investment of automatic rollover account funds;
4. Escheat considerations;
5. Beneficiary considerations;
6. Participant and government notice;
7. Prohibited transaction considerations; and
8. Coordination with PBGC missing participant rules.

DISCUSSION OF ISSUES

1. Post-Establishment Fiduciary Liability of Plan Sponsors and Other Plan Officials

ERISA Section 404(c)(3) was amended by EGTRRA Section 657 to provide that a participant is not considered to have exercised control over an automatic rollover account until the earlier of: (a) the date the participant transfers the money to another IRA; or (b) one year after the IRA is established. However, this control is considered to be immediately exercised if the IRA rollover is done in a "manner consistent with guidance provided by the Secretary [of Labor]."

It is critical that the safe harbor rules to be established by the Department provide that automatic rollovers be made without plan representatives retaining any ongoing fiduciary liability (other than that relating to the initial selection of the IRA fundholder or investments).

While the one-year retained liability rules exist in SIMPLE plans, the employees in those plans are generally still in contact with the employer. If the fiduciary in a SIMPLE context becomes aware of a problem with the choice of investment within the one-year period, he or she can notify the plan participants of the concern and recommend other vehicles.

In the cash-out context, on the other hand, the trustee of the qualified plan is turning the funds over to an IRA, which is owned by the participant and is not part of the plan. In this situation, IRA accounts may be created for people who have terminated employment (sometimes months or years before the IRA rollover account is established) and who either are not able to be located or are unresponsive to plan communications. The plan administrator's fiduciary status should not depend on whether the former participant can be located or whether the participant chooses to exercise dominion over the account assets. More importantly, plan sponsors are not equipped or generally required to monitor and exercise fiduciary control over individual accounts of distributees.

In addition, if a problem arises with the investment choice or the fundholder selection over time, the fiduciary's ability to act may be limited. The fiduciary may or may not be able to contact the participant to recommend that action be taken. Because the trustee of the plan is not the owner or co-owner of the IRA, the fiduciary will not have the authority to transfer the money to another investment vehicle or fundholder. Therefore, the fiduciary would be left with the responsibility for what occurs within that one-year period, but would not have the means to affect the outcome after the account is established.

ASPA Recommendation

ASPA recommends that the Department provide safe harbors for the automatic rollover process that enable the fiduciary to terminate its liability for the IRA at the time of

rollover. A safe harbor will permit the trustee to know that it has fulfilled its obligations to the participant, without putting the trustee in a position in which it has the responsibility for results but no ability to effect change to the account.

2. Inability to Obtain Accountholder Signature

Generally, participants own their IRA rollover accounts. However, logistical issues exist when someone other than an owner opens an account. In particular, financial institutions must be reassured that these accounts can be reasonably administered and that providing these accounts will not threaten the institution with liability or problems with the banking and securities regulators. As a result, the Department must coordinate with the FDIC, the SEC, and other regulatory entities to ensure that automatic rollover IRA accounts may be established and maintained within appropriate regulatory frameworks.

A significant consideration is raised by the fact that the participant will generally be unavailable to sign paperwork relating to the establishment of the account. While ASPA understands there is no federal law mandating that the account owner's signature be obtained when an IRA account is established, state laws may provide such a requirement. Even in absence of a statute requiring a signature by the accountholder, we understand that banks independently impose such a requirement, particularly in light of national security considerations after September 11. A signature provides the bank with a specimen signature, thereby providing some assurance that a person later requesting a withdrawal is indeed the accountholder.

If banks require an accountholder signature, it may be logistically impossible to open an "automatic" account if the owner is unavailable. This level of involvement by the participant defeats the purpose of an automatic rollover process. It makes automatic rollovers impracticable when the participant is unavailable (and that would significantly reduce the need for automatic rollovers, as they are generally not necessary if the participant is available).

One suggested alternative is for the Department to authorize a procedure whereby a participant consents to the automatic rollover (should it become necessary) at the time of plan enrollment. For example, plan enrollment forms could contain a clause that states, "By signing here, I authorize the trustee to open an IRA account in my name if, at any future time, my account is subject to the automatic rollover rules." However, some state or federal laws or regulations provide that such a signed document becomes "stale" after a period of time. Furthermore, many enrollments are currently performed electronically without a participant's written specimen signature. While electronic signatures are generally permitted under the law, this still does not solve the financial institution's concerns about being able to identify the accountholder by specimen signature.

Finally, how much effort must a plan administrator expend to locate a lost participant before the automatic rollover process is initiated? Is a mailing to the last known address sufficient? Must the plan administrator engage the services of a locator service before initiating the rollover? If there are obligations that are antecedent to the establishment of

an automatic rollover, in addition to the passage of time without a participant's communication or request for distribution, the plan administrator must be advised of what those obligations are so that they can be fulfilled.

ASPA Recommendation

ASPA recommends that the Department provide guidance that authorizes the opening of an account in the name of the participant as owner without the participant's signature. Furthermore, the Department or other appropriate federal government agencies need to advise banks and other financial institutions that it is permissible to open rollover IRA accounts under these circumstances so that the institutions are reassured that their actions comply with their fiduciary responsibilities and do not implicate national security concerns.

ASPA recommends that the Department and other governmental agencies explore whether the problem can be solved by allowing the participant at the time of plan entry to authorize the creation of an automatic rollover account should it become necessary, and whether an electronic signature will suffice.

ASPA recommends that the Department provide guidance for plan administrators regarding the actions that must be taken to attempt to locate a participant or beneficiary when no mailing address or residence is available prior to initiating the automatic rollover process.

3. Investment of Automatic Rollover Account Funds

Because the automatic rollover is performed without participant consent, the trustee or another fiduciary will need to determine what type of initial investment is appropriate for the account. This puts the trustee in a difficult position, under which the trustee may be subject to liability based on future market conditions, regardless of what initial choice is made. If the trustee protects principal, such as by selecting a money market account, the participant may sue, saying that the interest rate earned was abnormally low. If the trustee tries to protect long-term investments, the participant may sue because principal decreased with market fluctuations. If the trustee invests for the long term, the participant may resurface and desire the money immediately; if the trustee invests in a money market, the participant may lose out on higher investment returns available in other investment options. Since there is generally no communication with the participant prior to the establishment of the automatic rollover account, there is no way to know whether the proper investment horizon for the participant should be short- or long-term.

To the extent that the rollover account is invested in securities that are covered by federal and state securities laws, the investment may require registration, notice, and the provision of a prospectus to the accountholder. There is an exemption from some of these rules under Section 3(2)(2) of the Securities Act of 1933, but that exemption applies only to group annuity contracts in a qualified plan. Furthermore, other registration requirements and exemptions may be applicable at both the federal and state level.

If the qualified plan account permits investment direction by the participant, and the fundholder/recordkeeper will be the IRA trustee, it is possible that the investment selection available to the participant in the qualified plan will be similarly available to the IRA. In that case, it is possible for the qualified plan trustee to arrange for a "mapping" of the investments or an in-kind rollover of the invested qualified plan funds to the IRA. Mapping provides for continuity of investment for a participant who has affirmatively elected certain investment options under the plan.

ASPA also is concerned about the handling of employer securities in the account of a participant for whom an automatic rollover is being initiated. While a participant may want to retain employer securities while he is employed so as to more directly enjoy the fruits of his labor and his contribution to the company, it is common that participants do not want to retain such stock after they leave the company. Nonetheless, the specific wishes of a given participant in an automatic rollover situation cannot be discerned. Furthermore, many IRA holders will not accept the rollover of employer securities (particularly if they are not traded on a national exchange) or will only do so for additional fees.

ASPA Recommendations

ASPA recommends that the Department adopt rules that provide a clear safe harbor (or choice among several safe harbors) for the investment selection of the automatic rollover account. It is critical that the qualified plan trustee be able to prudently establish an automatic rollover account and know that it has fulfilled its fiduciary duty in doing so.

Furthermore, it is important that the selection of *any* of the safe harbors be *per se* appropriate, so that the choice of the fiduciary among safe harbor options will not subject the fiduciary to potential liability.

ASPA further recommends that the Department coordinate with the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, and any other governmental-agency, department, or regulatory entity, as needed, to facilitate the ability of plans to establish automatic rollover accounts in compliance with non-benefits laws and regulations.

Finally, ASPA recommends that the Department permit the automatic liquidation of employer securities held by the participant's account concurrent with the automatic rollover of such account to an IRA, and provide that to do so is not a breach of fiduciary duties.

4. Escheat Considerations

When an individual opens a bank account, and then lets it lay fallow for years, the account generally escheats to the state. States and financial institutions have procedures

under which the participant can go to the institution and the state at some later time to reclaim escheated funds.

Escheat raises special problems in the automatic rollover context, because the person who ultimately is due the money is not the person who opens the automatic rollover account. The accountholder may not know which financial institution is the custodian or trustee of the account. If the accountholder later seeks to obtain his benefits, it is possible that the plan sponsor is no longer in business, and the participant will have no facility by which to locate the escheated funds.

The escheat rules are further complicated by the fact that the employer, the fundholder, and the participant may all be located in different states. As a result, the state that obtains the escheated funds may vary from case to case, and that can produce additional complexity. Furthermore, different states have different escheat periods, and a fiduciary should not be charged with a duty to evaluate the effect of such rules on the participants' interest in the automatic rollover account.

ASPA Recommendations

ASPA recommends that the Department provide that the fiduciary is not required to take into account the impact of a given state's escheat rules when selecting a vehicle for the automatic rollover. Due to the importance of preserving participants' retirement benefits, the Department may wish to examine the broader issue of how and whether such accounts should be subject to escheat and whether state escheat laws are preempted by ERISA.

5. Beneficiary Considerations

One of the significant issues for automatic rollovers is: who is the beneficiary?

ASPA recognizes that most automatic rollover accounts will contain less than \$5,000. However, it is possible that there will be rollover monies in the account, and it is further possible that the participant engaged in significant estate planning as part of the designation of the beneficiary on the qualified plan account. If that is not respected as part of the rollover process, intended heirs (particularly children of a first marriage) may lose inheritances. Additionally, naming the estate as the beneficiary of the account produces a "no individual beneficiary" result required for minimum distribution requirements of Internal Revenue Code (the "Code") Section 401(a)(9), thereby requiring a 5-year payout after death and eliminating other potentially helpful minimum distribution options.

This beneficiary problem does not lend itself to an easy solution. It is important to recognize that, particularly in the case of a missing or non-responsive participant, there is simply no way for the plan administrator of the transferor qualified plan to know whom the participant would like to designate as beneficiary. Even if there is a beneficiary designation on file for the qualified plan, such designation will have been controlled by

the rules of Code Sections 401(a)(11) and 417, which require spousal consent to non-spousal beneficiary designations. Such rules do not currently apply to IRAs. Additionally, the fact that a participant once made a given beneficiary designation for a qualified plan account does not necessarily mean that this represents the participant's current wishes.

Moreover, it is unclear whether the law would support the transfer of a beneficiary from one legal instrument to another. Finally, attempting to transfer a beneficiary designation from the qualified plan to an IRA complicates the automatic rollover process and may introduce opportunities for errors to be made in the location and transmission of beneficiary information.

ASPA notes that beneficiary designations do not typically transfer automatically from the transferor plan to the recipient plan in rollover transactions between qualified plans.

ASPA Recommendations

ASPA recommends that the Department issue a rule under which the IRA contract itself, or in absence of a beneficiary provision in the IRA contract, state law control who is the beneficiary of the automatic rollover account.

6. Participant and Government Notice

Government notice of an automatic rollover is required for both retirement plan and banking law purposes. Furthermore, one of the most significant concerns about automatic rollovers, particularly in relation to escheat rules, is the ability of a participant to locate these rollover accounts years after they have been created—and possibly years after the sponsoring company and plan have been dissolved.

Another consideration for institutions holding IRA rollover accounts is the requirement under Treasury Regulation Section 1.408-8, Q&A-10, that such institutions advise IRA accountholders of any minimum distribution required for that year. (This rule becomes effective in 2004.) If an automatic rollover is effected for a participant who cannot be located, the recipient financial institution cannot fulfill this obligation.

ASPA Recommendations

ASPA recommends that existing reporting forms be modified to permit reporting of automatic rollovers. In particular, Form 1099R or Schedule SSA (Form 5500) may be used. To the extent that the FDIC or other regulatory agencies require reporting of these automatic accounts, these forms may be shared with those organizations.

ASPA recommends that the government take the information provided on automatic rollovers and create an Internet database that can be accessed by employees. This will answer concerns about employees losing track of their pension funds. While ASPA recognizes that this involves some cost, the benefit to participants who are trying to

locate retirement funds could be invaluable. Furthermore, the database should ideally be coordinated with the Social Security Administration's SSA filings and records.

ASPA recommends that the Department coordinate with the IRS to ensure that a failure of a financial institution to provide minimum required distribution information to an IRA accountholder is excused when such accountholder cannot be reasonably located.

7. Prohibited Transaction Considerations

It is reasonable to assume that the investment provider or custodian for a retirement plan will be an appropriate, low cost, and convenient recipient of automatic rollovers from the plan. There is no reason to believe that this fundholder/trustee is less qualified or prudent to act as the automatic rollover fundholder/trustee than a financial institution that is not currently part of the qualified plan's operations.

ASPA Recommendations

ASPA recommends the development of a class prohibited transaction exemption permitting the fundholder/trustee of the distributing qualified plan to become the trustee of the rollover IRA.

8. Coordination with PBGC Missing Participant Rules

ERISA Section 4050 requires that accounts for "missing participants" in a terminating defined benefit plan be turned over to the PBGC or invested in an insurance annuity. A "missing participant" is defined as a participant or beneficiary that cannot be located by the plan administrator after a diligent search.


If the account for a missing participant in a terminated defined benefit plan is \$5,000 or less (not counting any rollover account), it is unclear whether the funds should be automatically rolled over to an IRA pursuant to the automatic rollover rules or transferred to the PBGC pursuant to the missing participant procedures. Code Section 401(a)(34) provides that a plan will not be disqualified solely because it transfers missing participant funds to the PBGC pursuant to Section 4050 of ERISA. This language may indicate that Section 4050 takes precedence over any conflicting subsection of Code Section 401(a). Nonetheless, the coordination of these two legal provisions is open to question and prevents the plan administrator from proceeding with either alternative with any confidence that it is the correct course of action.


ASPA Recommendation


ASPA recommends that Department coordinate with the PBGC to establish a priority between the automatic rollover rules and the missing participant rules of ERISA Section 4050.

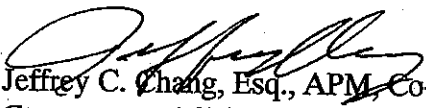
These comments were prepared by ASPA's 401(k) subcommittee of the Government Affairs Committee with the assistance of the DOL subcommittee of the Government Affairs Committee. Please contact us if you have any comments or questions regarding the matters discussed above.

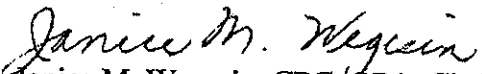
Prepared by:


Ilene H. Ferenczy, Esq., CPC, Chair
401(k) Subcommittee


Brian Graff, Esq.
ASPA Executive Director


R. Bradford Huss, Esq., APM, Co-Chair
Government Affairs Committee


Jeffrey C. Chang, Esq., APM, Co-Chair
Government Affairs Committee


Janice M. Wegesin, CPC, QPA, Chair
Administrative Relations Committee


Fredric S. Singerman, Esq., APM
DOL Subcommittee