Securities Industry Association

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
Washington, DC 20210

Re: Automatic Rollover RFI

Dear Sir or Madam:

On behalf of the Securities Industry Association (SIA) Retirement and Savings Committee, I am writing in response to the request for information (RFI) on the automatic Individual Retirement Account (IRA) rollover legislation enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). SIA brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. Collectively they employ more than 495,000 individuals, representing 97 percent of total employment in securities brokers and dealers. The U.S. securities industry manages the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2001, the industry generated $280 billion in U.S. revenue and $383 billion in global revenues.

SIA is very concerned about the implementation and effect of the automatic rollover provision. As we discuss in our submission, there are a number of legal and practical barriers that cast doubt on the viability of this proposal to discourage leakage. Notwithstanding this comment, SIA is pleased the Department of Labor (DOL) has issued the RFI to gain as much information from the plan and provider communities before moving forward with draft regulations. The following submission includes responses to the specific questions raised by the RFI as well as other issues identified by SIA members relating to the implementation of the automatic rollover provision.

Standards for Safe Harbor Entity

Any IRA custodian/trustee meeting the requirements of Internal Revenue Code Section 408(a)(2) and sponsoring an IRA that is either approved by the Internal Revenue Service (IRS) or is based on an IRS model form should automatically qualify as a safe harbor entity. No additional filing, registration, licensing, or separate reporting requirements of any kind should be imposed on entities that accept automatic rollovers.

Standards for Safe Harbor Initial Investment

The investment options granted safe harbor status should be broad enough to reflect the range of investment options curently available in employer-sponsored plans. SIA recommends that the options include a money market fund option or an interest-bearing bank account, certificate of deposit, or a fixed annuity. In addition, to accommodate plan sponsors who have made the fiduciary determination that other investment options are prudent options for participants, safe harbor status should also be granted to "life-cycle" or "funds of funds" targeted to a specific retirement date as well as a "default" investment option that might be specified under the employer's plan. Safe harbor status should also be granted to permit the plan sponsor to direct the IRA provider to "map" the existing account into investment options that are substantially similar to the investment options held in the participant's account while covered by the employer plan. Any expenses applicable to such investments should continue to apply.

Under Section 404(c)(3)(A) of the Employee Retirement Income Security Act (ERISA), the plan sponsor retains fiduciary liability for the investment of the assets rolled to the IRA until the IRA owner exercises control over the assets by either moving the assets to another IRA or by letting one year go by from the date of the initial transfer. SIA recommends that the DOL issue guidance clarifying that to the extent the initial IRA investment satisfied the safe harbor, the IRA owner shall be deemed to have exercised control over the IRA upon funding to such safe harbor investment, and the plan sponsor and IRA provider shall be relieved of fiduciary liability.

Costs and Fees

The IRA providers that agree to accept automatic rollovers should be allowed to set their own fees, costs and charges. SIA does not believe that it is viable to establish a criteria for a "low-cost" IRA that would receive special treatment under any proposed regulations. It has long been the position of SIA that the amount of fees should not be the sole determining factor in granting special status to an IRA provider. Cost should serve as only one of several factors in the selection of an IRA provider. Each entity has established different fee structures to take into account the services it provides and that does not lend itself to a standardized format. For example, a banking institution may have little or no "fee" associated with an IRA product. However, the account is likely invested in a vehicle that pays nominal interest. Likewise, an entity may eliminate or reduce establishment and/or annual maintenance fees for accounts with a value above a stated amount but charge individual transaction fees or impose asset management fees.

Fees, costs and charges should be eligible to be debited from the account by the IRA provider. The DOL may also wish to expressly allow the plan sponsor to deduct the establishment fee for the IRA from plan assets or otherwise arrange payment for the fee. This is warranted because it will relieve the IRA provider of the duty to liquidate assets in a fully-invested IRA to pay fees and costs associated with establishing the IRA. Finally, DOL should recognize that forcing the IRA provider to absorb certain fees results in higher costs for other clients who will effectively be subsidizing the rollover accounts which we believe will be more expensive to maintain than standard IRA accounts.

Transfers within One Year

The RFI asks if IRA providers should be required to refund or waive fees for IRAs that are terminated within one year of establishment. The costs involved to establish, process transactions, and comply with reporting and record retention requirements are incurred by the IRA provider or its agent, even if the IRA is terminated within one year. Therefore, we do not believe it is appropriate for DOL to impose a requirement that the IRA provider remit fees, refunds, or waivers for these accounts.

Prohibited Transaction Relief and Excess Contributions

SIA recommends that relief should be granted to the plan sponsor and IRA provider for the establishment and administration of the IRA in the event the automatic rollover is utilized and no IRA documents have been signed by the plan participant. In addition, IRA providers will need relief from determining whether the rollover amount is an eligible rollover distribution. Finally, the IRA providers will need guidance on how to deal with errors or other situations where funds have been mishandled – such as when the employer forwards too much or too little money.

Intermediary Business Models

Many member firms conduct business through third parties, including broker-dealers and banks. In this service model, IRA owners generally do business with the IRA provider through an intermediary appointed by the IRA owner. Many IRA providers do not have the infrastructure to deal with IRA owners directly in the operation of their day to day business. It is not clear, in the case of an automatic rollover, who would appoint the intermediary. The appointment of the intermediary by the plan sponsor may require amendments to many IRA documents, a significant and costly effort on the part of the IRA provider.

Legal Impediments

IRA providers face a number of legal impediments in attempting to comply with this provision. SIA believes that most of the accounts that will be established as a result of the automatic rollover provision will be done on behalf of missing plan participants. As a result, such accounts will be established without the signature of a bona fide account holder or accurate identification information. These issues raise a number of concerns for IRA providers. First and foremost, IRAs are regulated by the Treasury Department and the IRS. As a result, many of the legal impediments raised by the automatic rollover provision can only be resolved in cooperation with these two entities.

Validity of the IRA document. It is customary for a client wishing to open an IRA account to complete a firm-specific IRA application or agreement. The agreement sets forth the rights and responsiblities of the IRA provider and the client. This agreement is the basis of the contractual arrangement between the IRA provider and the client and sets forth the terms and conditions of the administration of the IRA, including application of fees, the handling of legal

disputes, particularly arbitration agreement provisions, beneficiary designations, etc. If the IRA provider is unable to obtain a signature on the application, will the document still be valid? Will the assets still be considered tax deferred? Some type of guidance would be needed to give IRA providers relief to administer these accounts consistent with their other IRA accounts and clarify how IRA providers who offer brokerage accounts would bind IRA owners to arbitation agreements/provisions without the IRA owner's signature. Investment direction by anyone other than the depositor or an expressly appointed investment manager may also not be permissible. Thus, the language on these forms would need to be modified to provide for these types of accounts. Finally, IRA providers must be able to rely on their own documents to determine default beneficiaries.

The language currently contained in IRS forms must also be reconciled with the probability that these accounts would be established without a signature. The IRS Form 5305 does not accommodate the adoption of an IRA by anyone other than the prospective IRA owner. In addition, IRS relief will be necessary for non-bank custodians whose approval letters may not permit the IRA provider to direct investments.

The tax reporting aspects of IRAs must also be reconciled with the automatic rollover IRAs. IRA providers will need relief from mandatory tax disclosures, including the delivery of IRA disclosure statements, Form 5498, and minimum required distribution reporting. Relief from these types of disclosures will be necessary because the IRA provider relies on certain information provided by the client. In the case of the automatic rollover IRA, the provider must rely on information provided by the employer (such as address, social security number, birthdate, etc.) which may or may not be accurate, complete, or updated.

Seven-Day Revocation Period. IRA providers receiving automatic rollovers should be protected from having to restore investment losses upon revocation by the IRA owner. Generally, an IRA owner is given seven days after the receipt of an IRA disclosure statement to exercise his or her right of revocation. If the IRA owner does not receive a disclosure statement before the IRA is established or at the same time the IRA is established, will the revocation period continue to run? If so, the IRA provider may be subject to significant losses. As a result, the SIA recommends that the seven-day revocation period begins on the day the rollover contributions are initially deposited in the IRA.

State Escheatment Laws. IRA providers may also be subject to state unclaimed property and escheat laws because state law applies to IRA accounts. In some states, the application of the escheat laws will make it even more difficult for a former plan participant to track down a prior plan account or benefit. Forcing plan sponsors to maintain the accounts is also not effective because employers go out of business, merge, or change locations. Workers would be better served if there was a single place to go to locate lost accounts.

Compliance with other federal requirements. IRA providers are typically financial services firms subject to a wide array of other federal requirements. Brokerage firms are subject to laws under the jurisdiction of the Securities and Exchange Commission (SEC) as well as rules promulgated by self-regulatory bodies like the New York Stock Exchange and the National Association of Securities Dealers (NASD). SIA is concerned that complying with the automatic

rollover provisions will result in conflicts with legal requirements set forth by these other organizations. First, NYSE Rule 405 "know your customer" requirements raise legal barriers for our members. Under Rule 405, member organizations must use "due diligence" to learn about their clients, which includes obtaining information about their age, estimated income, net worth, marital status, dependents and investment objectives. Thus, brokers will need some relief from Rule 405 to the extent that the information cannot be ascertained.

Secondly, NASD Rule 2310, Recommendations to Customers may also lead to conflicts. Under this rule, a broker-dealer will need relief since they are relying on investment direction by a third party.

Finally, the SEC's books and records rules, Rule 17a-3 and Rule 17a-4 under the Securities Exchange Act of 1934 ("Exchange Act")(hereinafter the "Books and Records Rules"), specify minimum requirements with respect to the records that broker-dealers must make, and how long those records and other documents relating to a broker-dealer's business must be kept. This is another area where relief will be needed.

Anti-money laundering. It is unclear if the Patriot Act – the federal statute which requires financial services firms to monitor suspicious activity – would apply to these automatic rollovers. Under the law, firms are required to collect specific identification information such as name, address, social security number, and birthdate. The IRA provider may or may not be able to rely on employer-provided information. In many instances, this information may be available from the employer. However, there will be many other instances when the information may be incomplete, outdated, or simply incorrect. Once this information is collected, the firm is required to *verify* the information. If the account is opened in a face to face exchange, the firm could rely on a government issued identification such as a driver's license. Unfortunately, most of these accounts will be opened without any type of signature or contact with the former plan participant. The Patriot Act does provide for verification methods when an account is not opened in person through the use of special databases operated by credit bureaus, etc. However, if the database method is utilized, the customer must be notified – something that will be very difficult to do if the customer cannot be found.

Impact on Small Entities

Small business owners are focused primarily on running their business. Any additional burdens placed upon them to select and establish "automatic rollover" IRAs will act as an additional deterrent to their sponsoring a qualified retirement plan.

Costs of Compliance

The RFI requested information on the actual costs of compliance. While the "costs" are difficult to estimate, at a minimum costs will arise as a result of the need to amend documents, operational forms, and applications. Costs and resources will also need to be directed toward revising investment procedures, modifying information systems, retraining firm personnel, and hiring legal counsel to draft documents and seek relief from other federal agencies with responsibility in these areas.

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We believe that the administrative and fiduciary issues that arise in instances where the plan participant cannot be found far outweigh any potential benefits. We recommend that the Department of Labor work with Congress and the plan provider community to formulate a more appropriate solution. (See Attachment: Proposal to permit PBGC to take over these accounts). If you have any questions regarding our submission, please contact me at (202) 326-5353.

Sincerely,

Liz Varley
Staff Adviser
Retirement & Savings Committee

cc: Bill Sweetnam
Carol Gold

Permit PBGC To Receive Automatic Rollovers

Present Law

As part of EGTRRA, Congress directed the Department of Labor (DOL) to provide regulations for a mandatory, default option for distributions from employer-sponsored retirement plans that:

- Exceed $1,000;
- Are subject to the $5,000 cash-out provisions and
- Are eligible rollover distributions.

The rollover to an IRA for a participant that meets these criteria is made to a designated IRA unless the participant affirmatively elects otherwise. This provision applies to distributions that occur after the DOL adopts final regulations.

Issue

By definition, the accounts covered by this rule are small accounts that are likely to belong to employees who cannot be found by the plan sponsor. These accounts would be rolled to an IRA custodian that will likely have just as much difficulty contacting the participant and will simply function as a custodian for the funds. It is likely that regulatory guidance will require the institution to invest the funds in a conservative investment vehicle such as a money market fund or other cash equivalent leading to a diminished account balance that does not keep pace with inflation.

Transferring these rollovers to IRA custodians will also create conflicts with other federal and state regulatory requirements. At the federal level, securities firms must obtain specific account information and a signature before establishing customer accounts. Under the change, this will be impossible to obtain and could result in the firm violating rules under the securities laws. The custodian will also be required to engage in on-going attempts to find the owner of the IRA, just as is currently required for inactive accounts.

The inability to find participants may also trigger the so-called "Lost Property" statutes. These state laws govern the disposition of property held by custodians for persons who have not claimed it after a period of years. The IRA custodian may be forced to eventually transfer these lost accounts to a state. This transfer will make it even more difficult for the participant to find assets.

Proposed Change

Plan administrators would be permitted, but not required, to elect to transfer eligible rollover distributions to the Pension Benefit Guaranty Corporation (PBGC). This proposal is complementary to the current proposals to expand the PBGC missing participant program to terminated multi-employer plans and defined contribution plans.