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INVESTMENT COMPANY INSTITUTE

March 10, 2003

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

Re: Automatic Rollovers RFI

Ladies and Gentlemen:

The Investment Company Institute[1] (the "Institute") commends the Department of Labor for its issuance of the request for information ("RFI") on the automatic rollover provision of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). As the Department is aware, the effect of EGTRRA section 657[2] is far-reaching. In order to maintain their tax-qualified status, qualified plans must establish a default mechanism under which amounts subject to the rule are automatically rolled over to an IRA designated by the plan administrator, unless the participant affirmatively elects to have the amount transferred to another vehicle or to receive it directly. Section 657(c) of EGTRRA directs the Department of Labor to prescribe regulations providing for safe harbors under which the designation of institutions and investment of funds would be deemed to satisfy the fiduciary requirements of section 404(a) of ERISA.

The automatic rollover provision of EGTRRA was designed to encourage individuals to preserve their pension assets for their retirement years. As providers of the mutual funds in which many employer-sponsored plans and IRAs invest,[3] as well as recordkeeping, trust and other administrative services, Institute members strongly support this policy objective. We believe, however, that in order to advance this

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,929 open-end investment companies ("mutual funds"), 553 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.322 trillion, accounting for approximately 95% of total industry assets, and over 90.2 million individual shareholders.

[2] Section 657 of EGTRRA added section 401(a)(31)(B) to the Internal Revenue Code.

[3] As of year-end 2001, about $2.3 trillion in retirement assets were invested in mutual funds. The $765 billion in 401(k) plans represents about 44 percent of all 401(k) plan assets. The $1.2 trillion in IRAs represents 49 percent of all IRA assets.

objective, it is important to minimize the provision's legal and operational difficulties, many of which will arise because individuals likely to become subject to the automatic rollover rules may be "missing participants" – *i.e.*, individuals whom the plan administrator would have difficulty locating and, therefore, would likely be unavailable following the automatic rollover.

To the extent that the regulatory implementation of EGTRRA's automatic rollover provision results in burdensome and costly requirements, these difficulties will be magnified – discouraging financial institutions from serving as IRA providers under the automatic rollover rules. This, in turn, will reduce the choices available to plan sponsors to the detriment of participants. The Institute, therefore, provides the following recommendations to enhance the administrability of the automatic rollover rules, while protecting the interests of plan participants and IRA investors.

I. SAFE HARBOR STANDARDS

A. Safe Harbor Investments

The employer, in its role as a plan fiduciary, is responsible for prudently selecting and monitoring both the plan's investment options and the plan's service providers. In meeting these fiduciary responsibilities, employers must consider a broad range of factors unique to their workforce. We therefore urge the Department to establish multiple categories of safe harbor investments, rather than a single type of investment that may not be suitable for all plans or participants. The Institute recommends that the Department's guidance set forth the following safe harbor categories.

First, low risk investment vehicles, such as money market funds, should be deemed to be safe harbor investments under the automatic rollover rules. Specifically, we suggest as a safe harbor the category of "income producing, low risk, liquid" funds – a type of investment described in the Department's ERISA section 404(c) regulations.[4] The Department should include this category of investments as a safe harbor, as many plan sponsors would prefer to select a conservative investment for their participants' IRAs.

Second, where a defined contribution plan specifies a default investment option for its participants, that investment vehicle also should qualify as a safe harbor investment under the IRA. For plans that have such a default option, the plan sponsor has already selected a default investment for plan assets that have not been directed toward a specific investment alternative. Such default investments typically consist of fixed income funds, such as money market funds, or "balanced" funds that invest in a mixture of equity and fixed-income securities. Importantly, this selection would have been made pursuant to ERISA's fiduciary standards, under which plan fiduciaries must

[4] *See* 29 C.F.R. § 2550.404c-1(b)(2)(ii)(C)(*2*)(*ii*).

act prudently and solely in the interests of participants. The same vehicle, therefore, should qualify as a safe harbor investment under the IRA to which the account balance is transferred.

Third, the investment of IRA assets pursuant to a mapping process should fall within a safe harbor. Under this approach, an account's investments under the plan would be matched with the same investment vehicle(s) available in the IRA.[5] Investments made in accordance with this approach should qualify as safe harbor investments under the automatic rollover rules, as it would continue the investments made in the participant's plan account.[6]

Lastly, the Department should consider providing that a diversified investment vehicle, such as a fund designed to be the complete investment program of a prudent investor, constitutes a safe harbor investment under the automatic rollover rules. For example, the guidance could provide that balanced funds (which invest in a mix of equity and fixed-income securities) and "lifecycle" funds (which are diversified investments that evolve over time to a more conservative asset allocation) are deemed to be safe harbor investments. Indeed, revenue rulings in the context of automatic plan enrollment identified balanced funds as investments into which plan amounts could be invested where participants did not make an affirmative election.[7]

In our view, the foregoing categories would serve as appropriate safe harbors and provide plan fiduciaries with the flexibility they need to select default investments suitable for their workforce. We ask the Department to adopt these categories as safe harbors and provide fiduciary relief — commencing at the point of distribution from the plan — for plan sponsors that select them.[8] Consequently, consistent with the

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[5] To the extent that a subset of the plan's investment options are not available in the IRA or other fund-level requirements, such as minimum fund investment thresholds, prevent an investment from being mapped from the plan to the IRA, the safe harbor guidance should provide that those investments that can be mapped may be mapped, even if the remaining balance is invested in accordance with one of the other safe harbor categories, or invested pro rata among the investment alternatives to which amounts can be mapped.

[6] Under the default plan investment approach and the mapping approach described above, it is possible that the particular share class of an investment offered under a qualified plan may not be available under the IRA. In the case of mutual funds, for example, an "institutional" share class of a fund may not be offered to IRA investors. Consequently, we ask the Department to clarify that an IRA's investment in a share class available to the general public of the investment vehicle offered under the plan would be considered to meet the requirements of this safe harbor, so long as the investment is otherwise mapped properly.

[7] *See, e.g.*, Rev. Rul. 98-30, 1998-25 I.R.B. 8 (automatic enrollment guidance on cash or deferred arrangements); Rev. Rul. 2000-33, 2000-31 I.R.B. 142 (automatic enrollment guidance on 457 plans).

[8] In addition, the safe harbor rules should address the Department's views articulated in Revenue Ruling 2000-36, which discusses the permissibility of direct rollovers of involuntary distributions. *See* 2000-31 I.R.B. 140 (footnote 1). Specifically, the Department should provide that any safe harbor fiduciary guidance under EGTRRA's automatic rollover provision also would apply to automatic rollovers of amounts under $1,000 — which are not covered by the statute — should the plan sponsor elect to have such a rule.

Department's position articulated in Revenue Ruling 2000-36,[9] the participant would cease to be a participant covered by the plan and the distributed assets would cease to be plan assets. We note that the Department has specific statutory authority to provide such fiduciary relief.[10]

B. Safe Harbor Entities

Should the Department consider providing safe harbor guidance at the IRA provider level, we would urge that all IRA trustees and custodians meeting the current requirements of Code section 408(a)(2) qualify as safe harbor institutions. Well-established banking rules and Treasury regulations setting forth non-bank IRA trustee standards[11] impose qualification requirements on IRA trustees and custodians. Moreover, limiting safe harbor institutions to a subset of IRA providers, in effect, would prevent otherwise qualified firms from offering IRAs under the automatic rollover rules, leading to reduced competition among vendors and potentially diminishing the benefits and features offered to IRA owners.

C. Fees and Costs

The Department's RFI lists a number of questions relating to fees and costs associated with IRA investments. We strongly believe that any safe harbor guidance should avoid dictating specific standards with regard to the types and levels of fees relating to IRA providers or their products — including fees and costs relating to the establishment, termination, maintenance, surrender and investment of IRAs.

ERISA requires fiduciaries to monitor the reasonableness of fees and expenses charged by plan service providers. Plan sponsors are responsible for monitoring the quality, performance and cost of providers and investment options on an ongoing basis. The highly competitive nature of the defined contribution market attests to the fact that plan sponsors take cost considerations seriously. In the Department's view, a plan sponsor's selection of an IRA for its employees would be subject to such requirements.[12] It is therefore unnecessary to superimpose an additional layer of "reasonableness" standards governing fees and expenses.

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[9] *See* 2000-31 I.R.B. 140 (footnote 1).

[10] EGTRRA provides that the participant or beneficiary, following an automatic rollover, will be treated as exercising control over the assets in the IRA upon "(A) the earlier of — (i) a rollover of all or a portion of the amount to another individual retirement account or annuity; or (ii) one year after the transfer is made; *or* (B) *a transfer that is made in a manner consistent with guidance provided by the Secretary [of Labor]*." ERISA section 404(c)(3) (emphasis added). Thus, the statute clearly grants the Department regulatory authority to provide fiduciary relief beginning from the time of transfer.

[11] *See* 26 C.F.R. § 1.408-2 (describing qualification requirements for bank and nonbank IRA trustees).

[12] *See* Rev. Rul. 2000-36, 2000-31 I.R.B. 140.

Moreover, as the Department has recognized in long-standing regulations, whether compensation is reasonable "depends on the particular facts and circumstances of each case."[13] Cost is only one criterion in determining whether an IRA provider or its products are appropriate. Indeed, the model 401(k) fee disclosure form developed by the Institute and other industry groups in conjunction with the Department emphasizes that besides costs, "other factors of equal or greater importance to consider include the quality and type of services provided, the anticipated performance of competing providers and their investment products and other factors specific to . . . [the] plan's needs."[14] Imposing fee and expense standards through a safe harbor would artificially heighten the consideration of fees and effectively lead plan fiduciaries to select products or providers – based on this criterion alone – that may not be appropriate for participants.

Fee-specific restrictions under the safe harbor guidance also may dissuade institutions from offering these IRAs. With fewer institutions offering their services under the automatic rollover rules, participants' interests would not be served.

In lieu of imposing fee limitations on IRAs established under the automatic rollover rules, the Department could adopt an approach similar to that articulated in its interpretive bulletin on payroll deduction IRA programs. In this guidance, the Department determined that where an IRA provider offers its payroll-deduction IRA program to its own employees, the IRA provider is not establishing an ERISA "pension plan" (as an employer) if, among other things, the IRA products and applicable fees are the same as those provided to the general public.[15] Likewise, the automatic rollover guidance could provide that fees or costs associated with these IRAs are appropriate so long as they are the same as those charged to the general public.

II. LEGAL AND OPERATIONAL ISSUES

As the Department's RFI recognizes, the automatic rollover rules present numerous legal and operational issues that require regulatory clarification. The accounts covered by the automatic rollover rules will likely be small and belong to employees whom the employer would have difficulty finding. As a result, we anticipate that financial institutions serving as IRA providers also will have difficulty locating these individuals, thereby giving rise to several of the issues discussed below. Because some of these matters may fall outside the scope of the Department's regulatory authority, we ask that the Department of Labor, the Treasury Department, the Internal Revenue Service and other regulatory agencies work in close cooperation to resolve them.

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[13] 29 C.F.R. § 2550.408c-2 (defining "reasonable compensation" under ERISA section 408(b)(2), the prohibited transaction exemption for plan services).
[14] *See* http://www.dol.gov/ebsa/pdf/401kfefm.pdf.

[15] *See* 29 C.F.R. § 2509.99-1.

A. Establishment of IRAs Under the Automatic Rollover Rules

An IRA is typically adopted with the execution of an IRS-approved document, such as the IRS Form 5305, by the IRA owner. In the case of an IRA established for purposes of the automatic rollover rules, however, it will often be difficult to obtain the owner's signature, as many participants with accounts subject to the rules will likely be difficult to find or will fail to return paperwork provided to them by their employers. Accordingly, we seek clarification on how IRAs may be established where the employer, not the employee, is opening the account. Specifically, guidance should allow employers to establish these IRAs on behalf of individuals.[16]

This guidance also should specify that where an employer establishes such an account, the individual is bound by the terms of the IRA document, the relevant investment-related documents (such as a mutual fund prospectus) including those describing the investments initially selected by the employer, and any other documents that govern the IRA. These binding terms, for instance, would include the types of investments in which the IRA may or may not invest and the default beneficiary rules set forth in the applicable IRA document. Without such express guidance upon which financial institutions can rely, they will be very reluctant to accept these automatic rollover accounts.[17]

B. Disclosure Statement Delivery and Revocation Period

Treasury regulations provide that IRA providers must furnish to prospective IRA owners a disclosure statement and a copy of the governing instrument (*i.e.*, the IRA agreement). These documents must be received by the prospective IRA owner (1) at least seven days before the earlier of the date of IRA establishment or purchase of the account, or (2) less than seven days preceding, but no later than, the earlier of the date of establishment or purchase, if the prospective IRA owner is permitted to revoke the account not less than seven days after the earlier of the date of establishment or purchase. If the account is revoked, the individual is "entitled to a return of the entire amount of the consideration paid by him for the account . . . without adjustment for such items as sales commissions, administrative expenses or fluctuation in market value."[18]

Relief from this disclosure statement and governing instrument delivery requirement is necessary under the automatic rollover rules. It will be difficult, if not impossible, to assure a prospective IRA owner's receipt of these documents by the date of establishment in many situations, as employers often may need to establish IRAs on

[16] While not completely analogous, the rules under SEP-IRAs allow employers to take certain actions on behalf of employees. *See* Code section 408(k); Prop. Treas. Reg. § 1.408-7(d)(2).

[17] Regulatory guidance also should clarify that an employer's establishment of IRAs and other actions on behalf of an individual does not cause the IRA to be viewed as an ERISA-covered plan.

[18] *See* 26 C.F.R. § 1.408-6.

behalf of their employees. Thus, we urge that regulatory guidance provide relief from this requirement for IRAs established pursuant to the automatic rollover rules.

Clarification also is required with regard to the seven-day revocation period provided in the Treasury regulations. As noted above, a prospective IRA owner is permitted to revoke an IRA account by providing a revocation notice on or before a day not less than seven days after the earlier of the date of establishment or purchase.[19] Guidance should expressly provide that this seven-day revocation period commences on the earlier of the date of establishment or purchase — including those situations in which the employer establishes the IRA. Without such guidance, IRA trustees could not rely on the terms of the IRA document and could effectively serve as guarantors against market fluctuations indefinitely. This would likely deter many financial institutions from offering their products and services under the automatic rollover rules.

C. Anti-Money Laundering Issues

The USA PATRIOT Act requires financial institutions to implement anti-money laundering programs that include, among other things, the identification and verification of their customers.[20] The Treasury Department, the Securities and Exchange Commission and other government agencies, as well as self-regulatory organizations such as the National Association of Securities Dealers (NASD), have proposed rules and issued other guidance that relate to such anti-money laundering rules.

Among these are the Customer Identification Program (CIP) rules, which require financial institutions to obtain certain identifying information about a customer prior to opening an account (*i.e.*, person's name, residential address, date of birth and Social Security number). While the employer in the context of an automatic rollover may be able to supply some or all of the required information with respect to many participants, it is likely that information relating to certain participants will be unavailable.

In addition, the financial institution's CIP must include procedures for verifying the identity of customers to the extent reasonable and practicable. Verification can occur within a reasonable time before or after the customer's account is opened or the customer is granted authority to effect transactions with respect to an account. For accounts that are opened in person, financial institutions may verify the customer's identity through review of government-issued documentation such as a driver's license.

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[19] *See* 26 C.F.R. § 1.408-6(d)(4)(ii)(A)(2).

[20] Pub. L. 107-56. The Treasury Department, in conjunction with other regulatory agencies, has published guidance under this statute applicable to various industries and institutions. For example, the Treasury Department and the Securities and Exchange Commission jointly issued proposed rules in July 2002 under section 326 of the PATRIOT Act, which directed the Treasury Department to prescribe regulations setting forth minimum standards for financial institutions and their customers that relate to the identification and verification of any person who applies to open an account. *See, e.g.*, Financial Crimes Enforcement Network; Securities and Exchange Commission, Joint Notice of Proposed Rulemaking, "Customer Identification Programs for Mutual Funds," 67 Fed. Reg. 48318 (July 23, 2002).

However, where the account is not opened in person – as would often be the case with automatic rollovers – the verification requirement presents greater difficulties for financial institutions.

While the CIP rules allow verification through certain "non-documentary" methods, such as through credit bureaus or public databases, financial institutions that use these methods must notify customers that they are requesting information to verify the customer's identity. Under other laws, the individual's consent also may be required in order to obtain certain verifying information (*e.g.*, from a credit bureau). This, of course, would be problematic if the individual cannot be found. Furthermore, a financial institution's CIP must include procedures to respond to cases in which a customer's identity cannot be reasonably verified, such as closing the account or placing limitations on additional purchases.

We ask that the Department consider these issues in developing automatic rollover regulations and consult with the Treasury Department, the Securities and Exchange Commission and other relevant agencies to grant appropriate relief to IRA trustees and custodians.

D. Prohibited Transaction Relief

We believe that the automatic rollover rules generally do not implicate ERISA's prohibited transaction rules. In the situation where the plan sponsor is selecting itself or an affiliate as the IRA provider for its employees, however, we request that the Department clarify whether prohibited transaction relief is needed. To the extent that such relief is necessary, we would be pleased to assist the Department in the development of appropriate conditions under a possible prohibited transaction class exemption.

III. TRANSITION ISSUES

Finally, the Institute requests that the Department provide for a sufficient transition period in which IRA providers and plan sponsors could implement the new guidance. For instance, issuance of proposed regulations well in advance of the final regulation deadline of June 7, 2004 would help the retirement savings community prepare for the potential systems modifications that may be required. We also urge that the Department seek additional comments on the automatic rollover rules in connection with the issuance of proposed regulations and/or prior to their release.

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The Institute appreciates the Department's consideration of our recommendations. Please do not hesitate to contact the undersigned at 202-326-5837 if you have any questions concerning our comments.

Sincerely,

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Associate Counsel

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