

**DEPARTMENT OF LABOR****Pension and Welfare Benefits Administration****29 CFR Part 2550**

RIN 1210-AA92

**Fiduciary Responsibility Under the Employee Retirement Income Security Act of 1974; Automatic Rollovers****AGENCY:** Pension and Welfare Benefits Administration, Labor.**ACTION:** Request for information.

**SUMMARY:** Section 657(c) of the Economic Growth and Tax Relief Reconciliation Act of 2001 directs the Department of Labor (Department) to develop, through regulations, safe harbors relating to the automatic rollovers of certain mandatory tax-qualified plan distributions to individual retirement plans. Under these safe harbors, the designation of an institution and the investment of funds by a plan administrator to receive automatic rollovers in accordance with section 401(a)(31)(B) of the Internal Revenue Code (Code) would be deemed to satisfy the fiduciary requirements of section 404(a) of the Employee Retirement Income Security Act (ERISA). The purpose of this document is to request information from the public on issues relating to the development of these safe harbors and to assist in drafting regulations. The Department also seeks information on low-cost individual retirement plans for purposes of transfers under section 401(a)(31)(B) of the Code and for other uses that promote the preservation of assets for retirement income.

**DATES:** Written or electronic responses should be submitted to the Department of Labor on or before March 10, 2003.

**RESPONSES:** Written responses (preferably, at least three copies) should be addressed to the Office of Regulations and Interpretations, Pension and Welfare Benefits Administration, Room N-5669, U.S. Department of Labor, Washington, DC 20210, Attention: Automatic Rollovers RFI. All responses will be available for public inspection at the Public Disclosure Room, Pension and Welfare Benefits Administration, Room N-1513, U.S. Department of Labor, Washington, DC 20210. Electronic responses should contain "Automatic Rollovers RFI" in the subject line and be addressed to *e-ORI@pwba.dol.gov*.

**FOR FURTHER INFORMATION CONTACT:** Stacey A. Gillis or Katherine D. Lewis, Office of Regulations and

Interpretations, Pension and Welfare Benefits Administration, Room N-5669, U.S. Department of Labor, Washington, DC 20210, telephone (202) 693-8510. This is not a toll-free number.

**SUPPLEMENTARY INFORMATION:****A. Background**

Tax-qualified retirement plans are permitted to make an immediate distribution to a separating participant without the participant's consent if the present value of the participant's vested accrued benefit does not exceed \$5,000.<sup>1</sup> Recipients may choose to roll the plan distribution (cash-out) into an IRA<sup>2</sup> or another qualified plan, or they may retain the cash-out as a taxable distribution. Prior to making a distribution, plan administrators are required to provide the participant with a written explanation of the Code provisions under which the participant may elect to have the distribution transferred directly to an IRA or another qualified plan, the provision requiring tax withholding if the distribution is not directly transferred and the provisions under which the distribution will not be taxed if the participant transfers the distribution to an IRA or another qualified plan within 60 days of receipt.<sup>3</sup> In recent years, both plan sponsors and participants have indicated an interest in establishing rollover accounts as the default form of distribution option to encourage preservation of the amount distributed for retirement purposes and to mitigate the tax consequences to the participant with respect to the amount distributed.

In July 2000, the Internal Revenue Service (Service) issued Revenue Ruling 2000-36<sup>4</sup> approving a plan amendment which permitted a direct rollover to an IRA as the default distribution option for an involuntary cash-out of a qualified plan distribution of an amount greater than \$1,000 but less than or equal to \$5,000, whenever a separating employee failed to make an affirmative election to either choose a direct rollover or take a taxable cash payment. The Service held that the plan amendment requiring the direct rollover to an IRA in these circumstances did not cause the plan to fail to satisfy the requirements of sections 401(a)(31) and 411(d)(6) of the Code. The plan amendment also provided that in the case of a default direct rollover, the plan administrator would select an IRA

trustee, custodian, or issuer that is unrelated to the employer, establish the IRA with that trustee, custodian, or issuer on behalf of any separating employee, and make the initial investment choices for the account.

In this ruling, the Department advised the Treasury and the Service that, under Title I of the ERISA, in the context of a default direct rollover described in the ruling, the participant will cease to be a participant covered under the plan within the meaning of 29 CFR 2510.3-3(d)(2)(ii)(B), where the distribution constitutes the entire benefit rights of a participant, and the distributed assets will cease to be plan assets within the meaning of 29 CFR 2510.3-101. However, the Department also noted that the selection of an IRA trustee, custodian or issuer and IRA investment for purposes of a default direct rollover would constitute a fiduciary act subject to the general fiduciary standards and prohibited transaction provisions of ERISA.<sup>5</sup> In addition, the Department stated that plan provisions governing the default direct rollover of distributions, including the participant's ability to affirmatively opt out of the arrangement, must be described in the plan's summary plan description furnished to participants and beneficiaries.

Subsequent to the issuance of Revenue Ruling 2000-36, section 657 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Public Law 107-16, amended section 401(a)(31) of the Code to require that, absent an affirmative election by the participant, certain mandatory distributions from a qualified retirement plan must be directly transferred to an individual retirement plan<sup>6</sup> of a designated trustee or issuer. Specifically, section 657(a) of EGTRRA added a new section 401(a)(31)(B)(i) to the Code to provide that, in the case of a trust that is part of an eligible plan, the trust will not constitute a qualified trust unless the plan of which the trust is a

<sup>5</sup> See the Department's information letter to Diana Orantes Ceresi (Feb. 19, 1998) regarding the factors a plan fiduciary should consider in selecting a service provider. Among other things, a responsible plan fiduciary must engage in an objective process designed to elicit information necessary to assess the qualifications of the service provider, the quality of the services offered and the reasonableness of the fees charged in light of the services provided. Such process should also be designed to avoid self-dealing, conflicts of interest or other improper influence.

<sup>6</sup> Section 401(a)(31)(B)(i) of the Code requires the transfer to be made to an "individual retirement plan," which section 7701(a)(37) of the Code defines to mean an individual retirement account described in section 408(a) and an individual retirement annuity described in section 408(b), *i.e.* "IRA."

<sup>1</sup> Code sections 411(a)(11) and 417(e).

<sup>2</sup> "IRA" means an individual retirement account under section 408(a) of the Code and an individual retirement annuity under section 408(b) of the Code.

<sup>3</sup> Code section 402(f).

<sup>4</sup> Rev. Rul. 2000-36, 2000-2 C.B. 140.

part provides that if a mandatory distribution of more than \$1,000 is made and the distributee (generally the participant) does not elect to have such distribution paid directly to an eligible retirement plan or receive the distribution directly, the plan administrator must transfer such distribution to an IRA of a designated trustee or issuer. Section 657(a)(1)(B)(ii) of EGTRRA defines an "eligible plan" as a plan which provides for an immediate distribution to a participant of any "nonforfeitable accrued benefit for which the present value (as determined under section 411(a)(11) of the Code) does not exceed \$5,000".

Additionally, section 657(a) of EGTRRA added a notice requirement in section 401(a)(31)(B)(i) of the Code requiring the plan administrator to notify the distributee in writing, either separately or as part of the notice required under section 402(f) of the Code, that the participant may transfer the distribution to another IRA.<sup>7</sup>

As part of these new EGTRRA provisions, section 657(c)(2)(A) directs the Department to issue final regulations providing safe harbors under which the plan administrator's designation of an institution to receive the automatic rollover and the initial investment choice for the rolled-over funds would be deemed to satisfy the fiduciary requirements of section 404(a) of ERISA. Moreover, the provisions requiring all tax-qualified retirement plans to make automatic rollovers to IRAs the default option for involuntary distributions of certain defined amounts will not become effective until the Department issues the safe harbor regulations.

Section 657(c)(2)(B) of EGTRRA also states that the Secretaries of Labor and Treasury may provide, and shall give consideration to providing, special relief with respect to the use of low-cost individual retirement plans for purposes of Code section 401(a)(31)(B) transfers and for other uses that promote the preservation of assets for retirement income.

## B. Issues Under Consideration

### *Automatic Rollover Safe Harbors*

The Department is interested in comments regarding appropriate standards for the development of safe harbors under which the designation of an institution providing an IRA to receive the automatic rollover of funds and the initial investment choice for the rolled-over funds would be deemed to satisfy the fiduciary requirements of

section 404(a) of ERISA. A list of some of the issues with respect to which comments are requested is included below. Responses on other issues pertinent to the Department's consideration are also invited.

As a framework for these comments, the Department notes that existing Treasury regulations describe fundamental requirements that must be satisfied in order for IRAs to maintain their tax classification under the Code.<sup>8</sup> Any standards made part of a safe harbor would supplement such requirements.

### *Request for Information*

1. *Standards for Safe Harbor Entity:* What criteria should apply to the Department's determination that an IRA custodian, trustee or issuer (IRA provider) qualifies as a safe harbor entity? Should the standards differ depending on whether the IRA is an account or an annuity? Should IRA providers who are existing plan service providers receive any special consideration if plan investments can be rolled directly in-kind without transaction fees for liquidating plan investments and purchasing IRA investments?

2. *Standards for Safe Harbor Initial Investment:* What criteria should apply to the Department's determination that an initial investment qualifies as a safe harbor investment? Should consideration be given to including or excluding specific investment vehicles in the safe harbor? If mutual funds are included, should they be limited to passively invested mutual funds such as index funds or include all publicly traded mutual funds? Should the criteria include specific asset allocation standards?

3. *Establishment Costs:* What is the range of establishment costs that IRA providers charge for the establishment or set-up of IRAs of the typical size of an automatic rollover and how do they vary? What factors should be considered in determining the reasonableness of these costs imposed by an IRA provider under the safe harbor? Should regulations clarify that establishment

costs are either an expense of the distributing plan or a charge to the IRA funds of the account-holder?

4. *Termination Costs:* What is the range of termination costs that IRA providers charge for the termination or closure of IRAs of the typical size of an automatic rollover and how do they vary? What factors should be considered in determining the reasonableness of these costs imposed by an IRA provider under the safe harbor?

5. *Maintenance Fees:* What is the range of maintenance and administrative fees that IRA providers charge for maintaining and administering IRAs of the typical size of an automatic rollover and how do they vary? What factors should be considered in determining the reasonableness of these fees imposed by an IRA provider under the safe harbor?

6. *Investment Fees:* What types of fees would be associated with the initial investment of the IRA? What types of fees would be associated with the ongoing investment vehicle of the IRA? What factors should be considered in determining the reasonableness of these fees imposed by an IRA provider under the safe harbor? Should the IRA principal be guaranteed with all investment fees, maintenance fees and establishment costs being charged to investment earnings?

7. *Surrender Charges:* What is the range of surrender charges that investment vehicles for IRAs of the typical size of an automatic rollover are subject to upon surrender or redemption, how do they vary and what circumstances trigger their imposition? What factors should be considered in determining the reasonableness of these charges imposed by an IRA provider under the safe harbor?

8. *Transfers within One Year:* Do IRA providers refund or waive in whole or part establishment costs, termination costs, maintenance fees or surrender charges for IRAs that are withdrawn or directly rolled over within one year of establishment by the account-holder? Should the Department consider refund or waiver features in determining whether an IRA provider or initial investment qualifies for safe harbor treatment?

9. *Prohibited Transaction Relief:* Is there a need for prohibited transaction relief that would enable a plan sponsor, as the plan administrator, to select itself or an affiliate as the IRA provider, or to choose an initial investment in which it may have an interest? If relief is needed, what safeguards should be imposed with respect to such relief?

10. *Legal Impediments:* What legal impediments are plan administrators

<sup>7</sup> Conforming amendments to Code sections 401(a)(31) and 402(f)(1) were also made by section 657 of EGTRRA.

<sup>8</sup> For example, with respect to individual retirement accounts, 26 CFR 1.408-2(b)(2)(i) states that the trustee of an individual retirement account must be a bank (as defined in § 408(n) of the Code and regulations thereunder) or another person who demonstrates, in the manner described in paragraph (e) of the regulation, to the satisfaction of the Service, that the manner in which the trust will be administered will be consistent with § 408(e) of the Code and with the regulation. With respect to individual retirement annuities, 29 CFR § 1.408-3 describes, among other things, requirements that must be met in order to maintain the tax-qualified status of such annuity arrangements.

likely to encounter in establishing IRAs for automatic rollovers on behalf of separating employees? What legal impediments are financial institutions likely to encounter in designing and marketing IRAs for automatic rollovers?

11. *Disclosure*: Should the regulation impose any additional disclosure requirements on safe harbor IRA providers?

12. *Low-Cost IRAs*: Is there a need for special consideration of IRA providers who provide low-cost IRAs for automatic rollovers? What criteria should be used to demonstrate low-cost or the promotion of the preservation of assets for retirement income by IRA providers? What kinds of low-cost IRA products are available?

13. *Current Practices*: How many qualified retirement plans currently have mandatory distribution provisions? Typically, what are those provisions? How many mandatory distributions occur annually and what is the form of distribution? What are the associated costs?

14. *EGTRRA Provisions*: What additional administrative costs will compliance with the EGTRRA automatic rollover requirements impose on qualified retirement plans and the assets of plan participants?

*Impact on Small Entities*

In responding to the questions above, please address the anticipated annual impact of any proposals on small

business and small plans (plans with fewer than 100 participants).

All submitted responses will be made a part of the record of the proceeding referred to herein and will be available for public disclosure.

Signed at Washington, DC, this 2nd day of January 2003.

**Ann L. Combs,**

*Assistant Secretary, Pension and Welfare Benefits Administration, Department of Labor.*

[FR Doc. 03-281 Filed 1-6-03; 8:45 am]

**BILLING CODE 4510-29-P**