

**DEPARTMENT OF LABOR****Employee Benefits Security Administration****29 CFR Part 2550**

RIN 1210-AA92

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

AGENCY: Employee Benefits Security Administration, Labor.

ACTION: Final rule.

**SUMMARY:** This document contains a final regulation that establishes a safe harbor pursuant to which a fiduciary of a pension plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), will be deemed to have satisfied his or her fiduciary responsibilities in connection with automatic rollovers of certain mandatory distributions to individual retirement plans. This final regulation will affect employee pension benefit plans, plan sponsors, administrators and fiduciaries, service providers, and plan participants and beneficiaries.

**DATES:** Effective Date: This final regulation is effective March 28, 2005.

*Applicability Date:* This final regulation shall apply to the rollover of mandatory distributions made on or after March 28, 2005.

**FOR FURTHER INFORMATION CONTACT:**

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

Under the Internal Revenue Code of 1986, as amended (Code), tax-qualified retirement plans are permitted to incorporate provisions requiring 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> A distribution by a plan in compliance with such a provision is termed a mandatory distribution, commonly referred to as a "cash-out". Separating participants may

<sup>1</sup> Code sections 411(a)(11) and 417(e). See Code section 411(a)(11)(D) for circumstances where the amount of a cash-out may be greater than \$5,000, based on a participant's prior rollover contribution into the plan.

choose to roll the cash-out, which is an eligible rollover distribution,<sup>2</sup> into an eligible retirement plan,<sup>3</sup> or they may retain the cash-out as a taxable distribution. Within a reasonable period of time prior to making a mandatory distribution, plan administrators are required to provide a separating participant with a written notice explaining, among other things, the following: the Code provisions under which the participant may elect to have the cash-out transferred directly to an eligible retirement plan and that if an election is not made, such cash-out is subject to the automatic rollover provisions of Code section 401(a)(31)(B); the provision requiring income tax withholding if the cash-out is not directly transferred to an eligible retirement plan; and the provisions under which the distribution will not be taxed if the participant transfers the account balance to an eligible retirement plan within 60 days of receipt.<sup>4</sup>

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA),<sup>5</sup> section 401(a)(31) of the Code was amended to require that, absent an affirmative election by the participant, certain mandatory distributions from a tax-qualified retirement plan 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,<sup>7</sup> the trust will not constitute a qualified trust unless the plan of which the trust is a part provides that if a mandatory distribution of more than \$1,000 is to be made and the participant does not elect to have such distribution paid directly to an eligible retirement plan or to receive the distribution directly, the

plan administrator must transfer such distribution to an individual retirement plan. Section 657(a) of EGTRRA also added a notice requirement in section 401(a)(31)(B)(i) of the Code requiring the plan administrator to notify the participant 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 individual retirement plan.<sup>8</sup>

Section 657(c)(2)(A) of EGTRRA directed the Department of Labor (Department) to issue regulations providing safe harbors under which (1) a plan administrator's designation of an institution to receive the automatic rollover, and (2) the initial investment choice for the rolled-over funds would be deemed to satisfy the fiduciary responsibility provisions of section 404(a) of ERISA. Section 657(c)(2)(B) of EGTRRA 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) automatic rollovers and for other uses that promote the preservation of assets for retirement income.

Section 657(c)(2)(A) of EGTRRA further provides that the Code provisions requiring automatic rollovers of certain mandatory distributions to individual retirement plans will not become effective until the Department issues safe harbor regulations.

On March 2, 2004, the Department published a notice in the **Federal Register** (69 FR 9900) containing a proposed safe harbor regulation for the automatic rollover of certain mandatory distributions, designated as proposed § 2550.404a-2 of Title 29 (proposal). The standards contained in the proposal, as explained in the preamble, were based in part on comments the Department received in response to a Request for Information (RFI) published on January 7, 2003 in the **Federal Register** (68 FR 991). The Department also published a proposed class exemption in the March 2, 2004 edition of the **Federal Register** (69 FR 9846) to address certain prohibited transactions that may result in connection with automatic rollovers.<sup>9</sup> The Department received 45 comment letters in response to the proposed safe harbor regulation and related class exemption. Copies of

<sup>2</sup> See Code section 402(f)(2)(A).

<sup>3</sup> See Code section 402(f)(2)(B).

<sup>4</sup> Code section 402(f)(1).

<sup>5</sup> Pub. L. 107-16, June 7, 2001, 115 Stat. 38.

<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).

<sup>7</sup> 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." The staff of Treasury and IRS have advised the Department that the requirements of Code section 401(a)(31)(B) apply to a broad range of retirement plans including plans established under Code sections 401(a), 401(k), 403(a), 403(b) and 457. The Department notes that the safe harbor contained herein applies only to employee benefit pension plans covered under title I of ERISA. See *infra* note 20.

<sup>8</sup> Conforming amendments to Code sections 401(a)(31) and 401(f)(1) were also made by section 657 of EGTRRA.

<sup>9</sup> 69 FR 9846, as corrected at 69 FR 11043. <http://www.dol.gov/ebsa/regs/fedreg/notices/2004004552.htm>.

these comments are posted on the Department's Website.<sup>10</sup>

After careful consideration of the issues raised by the written comments on the proposal, the Department has modified the scope of the regulation and revised some of the conditions requisite to achieving relief under the safe harbor. The Department now is publishing in this notice, in final form, regulation § 2550.404a-2 of Title 29 (regulation), establishing a safe harbor pursuant to which a fiduciary will be deemed to have satisfied his or her fiduciary responsibilities in connection with rollovers of certain mandatory distributions to individual retirement plans. In modifying the regulation, the Department has attempted to strike a balance between preserving retirement assets for participants on whose behalf a rollover is made to an individual retirement plan and the costs attendant to establishing and maintaining such plans on behalf of the participants.

Set forth below is an overview of the regulation, with a discussion of the comments received in response to the proposal and changes made in response to those comments.

## B. Overview of Final Safe Harbor Regulation

### 1. Scope

Like the proposal, paragraph (a)(1) of the regulation provides that the safe harbor applies to the automatic rollover of a mandatory distribution described in section 401(a)(31)(B) of the Code, which limits such distributions to nonforfeitable accrued benefits (generally referred to as vested benefits), the present value of which is in excess of \$1,000, but less than or equal to \$5,000. For purposes of determining the present value of such benefits, section 401(a)(31)(B) references Code section 411(a)(11). Section 411(a)(11)(A) of the Code provides that, in general, if the present value of any nonforfeitable accrued benefit exceeds \$5,000, such benefit may not be immediately distributed without the consent of the participant. Section 411(a)(11)(D) of the Code also provides a special rule that permits plans to disregard that portion of a nonforfeitable accrued benefit that is attributable to amounts rolled over from other plans (and earnings thereon) in determining the \$5,000 limit. Inasmuch as section 401(a)(31)(B) of the Code requires the automatic rollover of mandatory distributions, as determined

under section 411(a)(11), which may include prior rollover contributions, the regulation provides safe harbor coverage for the automatic rollover of mandatory distributions containing such prior rollover contributions.

Several commenters recommended that the safe harbor be expanded to include mandatory distribution amounts of \$1,000 or less, which tax-qualified retirement plans are permitted to distribute 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>11</sup> A number of commenters also suggested that the safe harbor extend to distributions of amounts greater than \$5,000 (amounts beyond those otherwise permitted under section 411(a)(11) of the Code).

Taking into account the purpose and provisions of the safe harbor regulation, the Department is persuaded that application of the safe harbor to rollovers of mandatory distributions of \$1,000 or less is appropriate. In this regard, the Department believes that the availability of the safe harbor for such distributions may increase the likelihood that such amounts will be rolled over to individual retirement plans and thereby may promote the preservation of retirement assets, without compromising the interests of the participants on whose behalf such rollovers are made. Therefore, paragraph (a)(1) of the regulation has been modified to provide that the safe harbor in § 2550.404a-2 extends to certain other mandatory distributions not described in section 401(a)(31)(B) of the Code. A new paragraph (d) has been added to the regulation to address mandatory distributions of \$1,000 or less. With regard to distributions greater than \$5,000, the Department is not prepared to conclude that the framework for safe harbor relief, specifically the prescribed investment products, is appropriate for distributions in excess of the amounts otherwise subject to the automatic rollover requirements of section 401(a)(31)(B) of the Code. Accordingly, no modifications have been made to the regulation concerning such amounts.

Paragraph (b) of the regulation, like the proposal, provides that, if the conditions of the safe harbor are met, fiduciaries will be deemed to have satisfied their fiduciary duties under section 404(a) of ERISA with respect to both the selection of an individual retirement plan provider and the investment of funds in connection with an automatic rollover of a mandatory

distribution described in section 401(a)(31)(B) of the Code to an individual retirement plan, within the meaning of section 7701(a)(37) of the Code.

The regulation continues to make clear that the standards set forth in the proposed regulation apply solely for purposes of determining compliance with the safe harbor and that such standards are not intended to represent the exclusive means by which a fiduciary might satisfy his or her duties under ERISA with respect to automatic rollovers of mandatory distributions described in section 401(a)(31)(B) of the Code.

As noted above, section 657(c)(2)(B) of EGTRRA provides that the Secretary of the Treasury and the Secretary of Labor shall consider and may provide special relief with respect to the use of low-cost individual retirement plans. The Department considered the provision of such special relief and believes that the framework of the safe harbor encourages the use of low-cost individual retirement plans for purposes of rollovers under section 401(a)(31)(B) of the Code. The Department specifically invited public comment on whether, given the conditions of the proposal, further relief was necessary in this regard. While the Department did not receive comments specifically addressing the necessity of further relief regarding the use of low-cost individual retirement plans, a substantial number of comments concerned the fee and expense limitations, which relate directly to the cost of establishing and maintaining automatic rollover individual retirement plans. As discussed below, the regulation has been modified to reflect comments made concerning fees and expenses assessed in connection with distribution and maintenance of rolled-over funds into an individual retirement plan.

### 2. Conditions

The proposal provided that safe harbor relief is dependent on a fiduciary satisfying six conditions. These conditions related to the amount of distributions, the qualifications of retirement plan providers, permissible investment products, limits on fees and expenses, disclosure of information to participants and prohibited transactions. Except as discussed below, this regulation, while structured somewhat differently, generally retains the conditions of the proposal. Each of the conditions is discussed below.

#### Amount of Mandatory Distributions

The first condition, described in paragraph (c)(1) of the regulation,

<sup>10</sup> [http://www.dol.gov/ebsa/regs/cmt\\_autorollover.html](http://www.dol.gov/ebsa/regs/cmt_autorollover.html) (for the proposed safe harbor regulation); [http://www.dol.gov/ebsa/regs/cmt\\_autorolloverexe.html](http://www.dol.gov/ebsa/regs/cmt_autorolloverexe.html) (for the proposed class exemption).

<sup>11</sup> See *supra* note 1.

requires that, for the automatic rollover of mandatory distributions, the present value of the nonforfeitable accrued benefit, as determined under section 411(a)(11) of the Code, does not exceed the maximum amount permitted under section 401(a)(31)(B) of the Code. Although this condition is generally the same as the proposal, paragraph (d) has been added to provide safe harbor relief for mandatory distributions of \$1,000 or less that are directly rolled over.

One commenter requested clarification as to whether the amount of a participant loan would constitute a portion of the present value of the nonforfeitable accrued benefit for purposes of the safe harbor. This question involves an interpretation of sections 401(a)(31)(B) and 411(a)(11) of the Code and, therefore, is beyond the jurisdiction of the Department. Accordingly, this question has been referred to the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) for consideration. Rollover Distribution to an Individual Retirement Plan

The second condition of the regulation, described in paragraph (c)(2), requires that the mandatory distribution be directed to an individual retirement plan within the meaning of section 7701(a)(37) of the Code. Section 7701(a)(37) defines the term "individual retirement plan" to mean an individual retirement account described in section 408(a) of the Code and an individual retirement annuity described in section 408(b) of the Code. Accordingly, a bank, insurance company, financial institution or other provider of an individual retirement plan under the safe harbor is required to satisfy the requirements of the Code and regulations issued thereunder.<sup>12</sup>

The Department is adopting this condition without modification. No commenters objected to this condition or identified any problems in the existing Code or regulatory standards for individual retirement plans. However, a number of commenters did raise questions concerning the application of this provision. These questions

<sup>12</sup> For example, with respect to individual retirement accounts, 26 CFR 1.408-2(b)(2)(i) provides that the trustee of an individual retirement account must be a bank (as defined in section 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 IRS, that the manner in which the trust will be administered will be consistent with section 408 of the Code and regulations thereunder. With respect to individual retirement annuities, 26 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.

included whether fiduciaries can select multiple individual retirement plan providers at the same time or only use one, and whether multiple plans of the same employer may designate the same provider as the recipient for all automatic rollovers. The safe harbor regulation establishes neither minimums nor maximums in terms of the number of individual retirement plan providers to a plan or multiple plans of an employer. The regulation merely requires, without regard to whether there are one or more individual retirement plan providers, that mandatory distributions be directed to an individual retirement plan within the meaning of section 7701(a)(37) of the Code. One commenter requested clarification regarding the status of brokerage firms that qualify as non-bank trustee individual retirement plan providers under section 408 of the Code. In the Department's view, any individual retirement plan provider offering individual retirement plans as defined in section 7701(a)(37) of the Code is a qualified provider for purposes of the safe harbor.

#### Agreements With Individual Retirement Plan Providers

Several commenters urged the Department to clarify the obligations of plan fiduciaries in terms of reliance on representations of individual retirement plan providers concerning satisfaction of the conditions of the safe harbor regulation and monitoring compliance with the conditions of the regulation following the initial selection and distribution of funds to the individual retirement plan provider. In response to these and other issues, the Department restructured paragraph (c) to establish an explicit requirement for a written agreement on which the plan fiduciary may rely in making rollover distributions under the safe harbor regulation. As modified, paragraph (c)(3) now provides, as a condition for relief under the regulation, that a fiduciary enter into a written agreement with an individual retirement plan provider that specifically addresses, among other things, the investment of rolled-over funds and the fees and expenses attendant to the individual retirement plan. The Department anticipates that such information would be addressed in documents currently utilized by individual retirement plan providers in the normal course of their business and that special documents would not have to be prepared for purposes of the safe harbor.

To the extent that the terms and conditions of the agreement comport with the conditions of the safe harbor

regulation with respect to rollover distributions, the fiduciary will be able to evidence compliance with the regulation. In this regard, the fiduciary can rely on commitments of the individual retirement plan provider as reflected in the agreement(s) and is not required to monitor the provider's compliance with the terms of the agreement beyond the point in time funds are rolled over in accordance with the terms of the agreement. In other words, the plan fiduciary's responsibility with respect to mandatory rollovers ends at such time as the funds are placed with the individual retirement plan provider pursuant to an agreement that satisfies the conditions of the safe harbor. This position is consistent with the Department's view expressed in a footnote to Revenue Ruling 2000-36 relating to mandatory distributions.<sup>13</sup>

Inasmuch as the agreement is being entered into on behalf of a plan participant, the regulation further provides, at subparagraph (c)(3)(v), that the terms of the agreement are enforceable by the participant on whose behalf the fiduciary makes an automatic rollover to an individual retirement plan. Such a provision is consistent with the view that the obligations of the plan fiduciary end, and the rights of the former participant as the account holder begin, with the distribution of funds to the individual retirement plan provider.

#### Investment Products

Paragraph (c)(3)(i), (ii) and (iii) address the types of investments that are permitted under the safe harbor. While, as discussed below, a number of commenters suggested expanding the types of investments that would be permitted under the regulation, the Department has concluded that the limited approach of the proposal is more appropriate for safe harbor relief. This regulation, therefore, provides that the agreement entered into by the plan fiduciary must provide, with respect to investment of individual retirement plan funds, that (i) the rolled-over funds shall be invested in an investment product designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity; (ii) for purposes of (i), the investment product selected for the rolled-over funds shall seek to maintain, over the term of the investment, the dollar value that is equal to the amount invested in the product by the individual retirement plan; and (iii) the investment product selected for the rolled-over funds shall

<sup>13</sup> Rev. Rul. 2000-36, 2000-2 C.B. 140.

be offered by a State or federally regulated financial institution, which shall be: a bank or savings association, the deposits of which are insured by the Federal Deposit Insurance Corporation; a credit union, the member accounts of which are insured within the meaning of section 101(7) of the Federal Credit Union Act; an insurance company, the products of which are protected by state guaranty associations; or an investment company registered under the Investment Company Act of 1940.

As with the proposal, the standards in subparagraphs (c)(3)(i)-(iii) reflect the Department's view that, given the nature and amount of automatic rollovers, investments under the safe harbor should be designed to minimize risk, preserve assets for retirement and maintain liquidity. Such safe harbor investment products would typically include money market funds maintained by registered investment companies,<sup>14</sup> and interest-bearing savings accounts and certificates of deposit of a bank or a similar financial institution. In addition, safe harbor investment products would include "stable value products" issued by a regulated financial institution that are fully benefit-responsive to the individual retirement plan account holder. Such stable value products provide a liquidity guarantee of principal by a financially responsible third party and previously accrued interest for liquidations or transfers initiated by the individual retirement plan account holder exercising his or her right to withdraw or transfer funds under the terms of an arrangement that does not include substantial restrictions on the account holder's access to the assets of the individual retirement plan.

Several commenters endorsed the Department's view that safe harbor investment products should favor the retention of income and principal over growth. However, some commenters suggested expanding the types of permissible investment products. They suggested that the safe harbor should include investment products identical or similar to those in which the participant had directed his or her investments prior to the mandatory distribution. Some commenters recommended that the default investment options selected by

fiduciaries for account balances under the plan for which participants fail to provide investment direction should be included as permissible safe harbor investments. Other commenters urged the inclusion of balanced or diversified funds, because the necessarily low returns on the approved safe harbor investments, would not help retirement savings grow over time.

The Department continues to believe that an investment strategy adopted by a participant while in a defined contribution plan or a default investment chosen by a plan fiduciary at a particular point in time would not necessarily continue to be appropriate for the separating participant in the context of an automatic rollover, particularly given the relatively small account balances typically covered by the safe harbor. Further, the Department believes that, consistent with Congress' intent to preserve retirement assets for participants, the investment products in which mandatory distributions can be invested under the safe harbor should be limited to investment products that are consistent with this goal of preservation. In the Department's view, this would be limited to the class of investment products designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity. For these reasons, the Department retained the proposal's standards without modification in subparagraphs (c)(3)(i) and (ii) of the regulation.

One commenter requested clarification that the investment of rolled-over funds in safe harbor investment products offered by Puerto Rican financial institutions would satisfy the safe harbor's requirement. The Department believes that as long as the Puerto Rican financial institution offering the investment product meets the regulation's definition of "regulated financial institution", the investment of rolled-over funds in investment products offered by such Puerto Rican financial institution would not be precluded.

Several commenters appeared to confuse the terms "regulated financial institutions" and "individual retirement plan providers". These terms are defined for separate and distinct purposes by the regulation. An individual retirement plan provider is an entity that offers individual retirement plans to which a mandatory distribution must be transferred, while a regulated financial institution is an entity that offers the types of investment products in which a mandatory distribution must be invested. While it

is conceivable that one entity may meet both definitions, it is equally plausible that two entities will be involved. For example, a plan fiduciary may select a bank that qualifies as an individual retirement plan provider to receive a mandatory distribution and may also select certificates of deposit as a safe harbor investment that are offered by this same entity as a regulated financial institution. On the other hand, a plan fiduciary may select a financial institution that qualifies as an individual retirement plan provider to receive a mandatory distribution and may then select a safe harbor investment made available by this institution to its customers, such as a money market mutual fund, which is actually offered by a different entity, an investment company registered under the Investment Company Act of 1940, which qualifies as a regulated financial institution.

#### Fees and Expenses

Subparagraph (c)(3)(iv) of the regulation addresses the extent to which fees and expenses can be assessed against an individual retirement plan, including investments of such plan (e.g., establishment charges, maintenance fees, investment expenses, termination costs and surrender charges). Under the proposal, fees and expenses could not exceed amounts charged by the individual retirement plan provider for comparable individual retirement plans established for rollover distributions other than automatic rollovers. The proposal further provided that fees and expenses, other than those attributable to establishment of the individual retirement plan, could be charged only against the income earned by the individual retirement plan.

Most commenters objected to the provision limiting fees and expenses to income earned by the individual retirement plan. They argued, among other things, that the income to be generated by the investments permitted by the safe harbor against which expenses may be assessed would be very limited, while the costs attendant to maintaining such individual retirement plans would tend to be higher than individual retirement plans with respect to which the account holder contributes and maintains contact with the institution. Such constraints, it was argued, would limit the number of individual retirement plan providers available for rollover distributions in accordance with the safe harbor regulation. These commenters further argued that the comparability standard of the proposal provides adequate protection to

<sup>14</sup> Regarding money market mutual funds, prospectuses for such funds generally state that "an investment in the [money market mutual] Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your [the investor's] investment at \$1.00 per share, it is possible to lose money by investing in the Fund."

individual retirement plan account holders in both the setting of fees and expenses and services provided, given the competitive nature of the individual retirement plan marketplace generally.<sup>15</sup>

After careful consideration, the Department is persuaded that a comparability standard, without further limit, is sufficient to protect individual retirement plans from being assessed unreasonable fees, while avoiding the imposition of financial disincentives for individual retirement plan providers to offer plans for mandatory rollover distributions under the safe harbor. The Department has modified the regulation accordingly in subparagraph (c)(3)(iv).

#### Notice to Participants

The fourth condition for safe harbor relief, described in paragraph (c)(4) of the regulation, requires, like the proposal, that, prior to an automatic rollover, participants must be furnished a summary plan description (SPD) or summary of material modifications (SMM) that includes an explanation of the nature of the investment product in which the mandatory distribution will be invested, and an explanation of how fees and expenses attendant to the individual retirement plan will be allocated (*i.e.*, the extent to which expenses will be borne by the account holder alone or shared with the distributing plan or plan sponsor). In addition, the disclosure must identify a plan contact for further information concerning the plan's procedures, individual retirement plan providers, and the fees and expenses attendant to the individual retirement plan. For purposes of this condition, the plan contact can be identified by reference to a person, position or office, along with an address and phone number of the contact. It is anticipated that the contact, in response to requests from separated participants on whose behalf distributions have been made to an individual retirement plan, would be able to identify the individual retirement plan provider to whom a distribution was made for the particular participant.

Several commenters supported the disclosure provision as proposed, and others requested clarification on issues such as the timing of SPD or SMM revisions and the provision of electronic notice. Some commenters requested that the Department broaden the proposed disclosure condition to require that

separating participants be notified of automatic rollover procedures at the time a distribution is made in order to provide more timely information. One commenter recommended this approach as a permitted alternative to SPD or SMM disclosure, while another advocated for this approach in lieu of the SPD or SMM disclosure. Another commenter asserted that, in addition to SPD or SMM disclosure, a plan sponsor should be required to provide an individualized notice to separating participants before any rollover distribution is made, including all of the information required to be contained in the SPD or SMM, the participant's benefit amount, and generic tax information on direct transfers, rollovers, and distributions.

The Department continues to believe that information concerning automatic rollover procedures must be included in a plan's SPD or SMM.<sup>16</sup> The Department also believes that the SPD or SMM that is provided to participants before mandatory distributions are made, in conjunction with the notice required under Code section 402(f) that is provided on an individual basis within a specified period before a mandatory distribution is made, as well as the notice expressly added by EGTRRA under the Code,<sup>17</sup> ensure that participants and beneficiaries will be provided, and have access to, sufficient information about automatic rollovers. The Department is not persuaded that the benefits to participants that might be obtained by additional disclosures will, given the existing required disclosures, outweigh the costs and burdens attendant to such disclosure.

#### Prohibited Transactions

The fifth condition, described in paragraph (c)(5) of the regulation, conditions safe harbor relief on the plan fiduciary not engaging in prohibited transactions in connection with the selection of an individual retirement plan provider or investment products, unless such actions are covered by a statutory or administrative exemption issued under section 408(a) of ERISA; for example, a plan fiduciary that

received consideration from a financial institution in exchange for selecting that financial institution as the individual plan provider would have engaged in a prohibited transaction under ERISA section 406 that is not covered by either the statutory service provider exemption under ERISA section 408(b)(2) or an administrative exemption. This condition remains unchanged from the proposal, in part, because commenters did not request any changes.

As noted in "Background" above, the Department also published a proposed class exemption in the **Federal Register** that was intended to deal with prohibited transactions resulting from an individual retirement plan provider's selection of itself as the provider of an individual retirement plan and/or issuer of an initial investment held by such plan in connection with mandatory distributions from the provider's own pension plan. The Department received four comment letters that specifically addressed the proposed class exemption's conditions; these comments are discussed in the final class exemption, referenced below.

Simultaneously with publication of the regulation, the Department is publishing a final class exemption in today's **Federal Register**. Specifically, the exemption permits a bank or other financial institution to (1) select itself or an affiliate as the individual retirement plan provider to receive automatic rollovers from its own plan, (2) select its own funds or investment products for automatic rollovers from its own plan and (3) receive fees therefor. In the absence of this exemption, a bank or other financial institution would be required to direct automatic rollovers from its own plan for its own employees to a competitor as the individual retirement plan provider.

#### C. Miscellaneous Issues

In response to the Department's proposal, a number of commenters identified possible impediments that fiduciaries, banks and other financial institutions might encounter in connection with automatic rollovers. These commenters requested clarification on a number of issues, including perceived conflicts with state laws on signature requirements and escheat, Code and regulatory requirements, requirements under the USA PATRIOT Act,<sup>18</sup> section 404(c)(3) of ERISA, missing participant issues, and beneficiary designations under the distributing employee benefit plan. Issues raised by commenters concerning the possible application of state laws

<sup>15</sup> The Department notes that individual retirement plan providers are subject to section 4975 of the Code including the requirement that the fees and expenses may not exceed reasonable compensation within the meaning of section 4975(d)(2) of the Code.

<sup>16</sup> This condition is consistent with the Department's statement in a footnote to Revenue Ruling 2000-36, 2000-2 C.B. 140 requiring 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 SPD furnished to participants.

<sup>17</sup> Section 657(a) of EGTRRA added a notice requirement to section 401(a)(31)(B)(i) of the Code requiring the plan administrator to notify a participant in writing, either separately or as part of the required Code section 402(f) notice, that the participant may transfer the distribution to another individual retirement plan. *See supra* note 8.

<sup>18</sup> Pub. L. 107-56, October 26, 2001, 115 Stat. 272.

including signature and escheat requirements are beyond the scope of the regulation.

#### *Code Requirements*

In response to the RFI and the proposal, some commenters raised concerns with regard to Code requirements that may conflict with the establishment of individual retirement plans for purposes of automatic rollovers of mandatory distributions under section 401(a)(31)(B) of the Code. For example, one commenter raised issues concerning the application of the safe harbor to employer-sponsored plans in Puerto Rico, not all of which are governed by the Code. These Code issues are beyond the Department's jurisdiction and have been referred to Treasury and IRS for consideration. The Department has been informed that the staffs of Treasury and IRS are reviewing the current rules and regulations affecting distributions covered by the regulation and that guidance addressing the application of these rules to the automatic rollover of mandatory distributions is anticipated prior to the effective date of this regulation.

#### *USA PATRIOT Act*

A few commenters continued to express concern over the application of the customer identification and verification (CIP) procedures of the USA PATRIOT Act (the Act). These commenters' concerns mirrored those previously expressed in response to the Department's RFI. Generally, the perceived difficulties concern situations where a fiduciary is required to make an automatic rollover to an individual retirement plan, but the participant cannot be located or is otherwise not communicating with the plan concerning the distribution of plan benefits. If the CIP provisions of the Act were construed to require active participant involvement at the time an individual retirement plan is established on his or her behalf, fiduciaries would be unable to comply with the automatic rollover requirements of the Code and utilize this safe harbor.

In response to these concerns, the Department reiterates that it has been advised by Treasury staff, along with staff of other Federal functional regulators,<sup>19</sup> that they interpret the CIP requirements of section 326 of the Act and implementing regulations to require that banks and other financial institutions implement their CIP

compliance program with respect to an account, including an individual retirement plan established by an employee benefit plan in the name of a former participant (or beneficiary) of such plan, only at the time the former participant or beneficiary first contacts such institution to assert ownership or exercise control over the account. CIP compliance will not be required at the time an employee benefit plan establishes an account and transfers the funds to a bank or other financial institution for purposes of a distribution of benefits from the plan to a separated employee.<sup>20</sup> In January 2004, Treasury staff, along with staff of the other Federal functional regulators, issued guidance on this matter in the form of a question and answer, published in a set of "FAQs: Final CIP Rule," on the regulators' Web sites.<sup>21</sup>

#### *ERISA Section 404(c)(3)*

Several commenters requested that the Department clarify the relationship between ERISA section 404(c)(3), as added by EGTRRA section 657(c) and the safe harbor relief provided in the regulation under ERISA section 404(a). ERISA section 404(c)(3) provides that, in the case of a pension plan that makes a transfer to an individual retirement account or annuity under Code section 401(a)(31)(B), the participant will be treated as exercising control over the assets of the individual retirement account or annuity upon (A) the earlier of (i) a rollover of all or a portion of the account or annuity to another 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.

The Department confirms that this regulation is the guidance referred to in ERISA section 404(c)(3)(B). Consequently, a fiduciary's rollover of a mandatory distribution to an individual retirement plan under this regulation will be treated as "a transfer that is made in a manner consistent with guidance provided by the Secretary" under ERISA section 404(c)(3)(B). Immediately following such rollover, the Department will view the participant as exercising control over the assets of the individual retirement plan for purposes of ERISA section 404(c)(3).

<sup>20</sup> It is the Department's understanding that this interpretation applies to a broad spectrum of employee benefit plans including those covered by title I of ERISA and those established under Code provisions.

<sup>21</sup> See FAQs: Final CIP Rule at: <http://www.occ.treas.gov/10.pdf>; <http://www.fincen.gov/finalciprule.pdf>; <http://www.fdic.gov/news/news/financial/2004/FIL0404a.html>.

#### *Missing Participants*

Some commenters requested that the Department provide additional guidance in the regulation to plan fiduciaries of terminated defined contribution plans concerning missing participants. For example, one commenter suggested expanding the safe harbor beyond the automatic rollover context to handle missing participant issues. Although the Department is aware of the problems faced by plan fiduciaries in handling missing participants' accounts, the Department believes that these issues are beyond the scope of this safe harbor initiative on mandatory rollover distributions.

#### *Beneficiary Designations*

One commenter questioned whether an existing beneficiary designation under the distributing plan, whether made by a participant or a default designation under the terms of the plan, would transfer to the individual retirement plan into which the participant's benefit is rolled over. As stated above, in the Department's view, the rollover distribution of the entire pension plan benefit to which a participant is entitled into an individual retirement plan ends his or her status as a plan participant, and the distributed assets cease to be plan assets under Title I of ERISA. As a corollary to this view, a beneficiary designation under the distributing plan would cease to control the distribution of the rolled-over funds upon the death of the individual retirement plan account holder. Further, nothing in the regulation precludes an individual retirement plan provider from applying its own default beneficiary provisions under the terms of the individual retirement plan until an individual retirement plan account holder makes an affirmative designation under the terms of the individual retirement plan.

#### **D. Effective Date**

Section 657(c)(2)(A) of EGTRRA provides that the requirements of section 401(a)(31)(B) of the Code requiring automatic rollovers of mandatory distributions to individual retirement plans do not become effective until the Department prescribes a final regulation. Inasmuch as it appears clear that Congress did not intend fiduciaries to be subject to the automatic rollover requirements under the Code in the absence of a safe harbor, the Department as well as Treasury and IRS believe that the effective date of the Code's rollover requirement must be determined by reference to the effective date of this regulation, which is the

<sup>19</sup> The term "other Federal functional regulators" refers to the other agencies responsible for administration and regulations under the Act.

point in time when plan fiduciaries may first avail themselves of the relief provided by the safe harbor. In this regard, the Department proposed to make the regulation effective 6 months after the date of its publication in the **Federal Register** in order to afford plan fiduciaries adequate time to amend their plans, distribute required disclosures and identify institutions and products that would afford relief under the final safe harbor regulation.

A few commenters suggested that the effective date of the regulation should be delayed for one year following its publication to provide sufficient time for fiduciaries to comply with the conditions of the safe harbor and individual retirement plan providers to develop individual retirement plans for the automatic rollover market. Other commenters requested a one year delay based on the many outstanding issues that require clarification from Treasury and IRS.

After careful consideration of the comments, the Department, in consultation with the staffs of Treasury and IRS, has concluded that delaying the effective date for 6 months following publication in the **Federal Register** will provide most plans adequate time to implement processes necessary to take advantage of the safe harbor relief provided by the regulation. In particular, the Department notes that the regulation will not require the comprehensive systems changes required under the proposal's earnings limitation on fees and expenses. Accordingly, paragraph (e) of the regulation provides that the regulation shall be effective and shall apply to any rollover of a mandatory distribution made on or after the date 6 months following publication in the **Federal Register**.

The Department notes that fiduciaries may rely in good faith on the regulation for purposes of satisfying their fiduciary responsibilities under section 404(a) of ERISA with regard to the selection of an institution to receive a rollover of a mandatory distribution and the initial investment choice for the rolled-over funds made before the effective date of this regulation.<sup>22</sup>

### E. Regulatory Impact Analysis

#### Summary

This regulation establishes conditions under which a fiduciary will be deemed to satisfy the fiduciary obligations under

section 404(a) of ERISA in connection with the automatic rollover of a mandatory distribution of between \$1,001 and \$5,000, as described in amended Code section 401(a)(31)(B), and certain other distributions described in section 411(a)(11) of the Code and not described in section 401(a)(31)(B). The savings arising from this safe harbor will substantially outweigh its costs. Benefits will accrue to fiduciaries through greater certainty and reduced exposure to risk, and to former plan participants through regulatory standards concerning individual retirement plan providers, investment products, preservation of principal, rates of return, liquidity, fees and expenses, and disclosure. The safe harbor will help preserve the principal amounts of automatic rollovers of mandatory distributions by ensuring that the various fees and expenses applicable to the individual retirement plans established for mandatory distributions are not larger than those charged by the provider to individual retirement plans established for reasons other than the receipt of a rollover distribution subject to Code section 401(a)(31)(B). It is assumed, for purposes of cost estimates presented here, that all fees, to the extent that they meet the condition related to comparability, will be charged to the individual retirement plan.

Individual retirement plan establishment and maintenance fees for participants are estimated, at the upper bound at \$21.6 million, \$7.2 million of which are costs associated with changes to the regulation. Automatic rollovers of mandatory distributions may give rise to other costs as well, such as investment expenses, termination charges, and surrender charges. The magnitude of some of those expenses will relate to the actual investment products selected. The range of possible costs that relate to investment products is considered too broad to support meaningful estimates.

The EGTRRA amendment will generate one-time administrative compliance costs to plans of an estimated \$139 million. Cost to plans associated with modifying a summary plan description or summary of material modifications to satisfy the safe harbor conditions are estimated at \$13 million.

Annually, on aggregate, the EGTRRA amendment and the regulation are expected to affect 361,000 former participants, preserving retirement savings of an estimated \$270 million and creating tax savings of approximately \$77 million. The guidance provided by the regulation will result in a savings of administrative compliance costs for plans of about \$92

million by lessening the time required to select an individual retirement plan provider, investment product, and fee structure that are consistent with the provisions of Code section 401(a)(31)(B) and ERISA section 404(a) with respect to automatic rollovers of mandatory distributions. Finally, a small number of defined benefit plans will benefit annually from reduced premiums to the Pension Benefit Guaranty Corporation (PBGC) of approximately \$202,200.

Further discussion of costs and benefits of the EGTRRA amendment and the regulation, and the data and assumptions underlying these estimates, will be found below.

#### Executive Order 12866 Statement

Under Executive Order 12866, the Department must determine whether a regulatory action is "significant" and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Under section 3(f) of the Executive Order, a "significant regulatory action" is an action that is likely to result in a rule (1) having an annual effect on the economy of \$100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant"); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. OMB has determined that this action is significant under section 3(f)(4) because it raises novel legal or policy issues arising from the President's priorities. Accordingly, the Department has undertaken an analysis of the costs and benefits of the regulation. OMB has reviewed this regulatory action.

#### 1. Costs of the EGTRRA Amendment and the Regulation

The Census Bureau's 1996 Survey of Program Participation (SIPP), Wave 7 Pension Benefits Module collected information as to the number, uses, and values of lump sum distributions from private pension plans in 1997. The survey responses show whether a distribution was mandatory or voluntary, and whether the amount involved was "Rolled over into another

<sup>22</sup> The Department notes, however, that the related final class exemption published today in the **Federal Register** cannot be relied upon for prohibited transaction relief prior to the effective date of the regulation.

plan, an IRA, or an individual retirement annuity" ("rolled over"). The number of lump sum distributions that are less than \$5,000 and that were characterized as mandatory and put to other specific uses enumerated in the survey instrument ("lump sums") has been used for the purpose of this analysis to approximate the number of participants in plans with mandatory distribution provisions that might fail to make an affirmative election. The number of automatic rollovers of mandatory distributions that will occur because of the Code amendment and the regulation may be smaller than the number of lump sums because some of these participants may have made an affirmative election. It seems reasonable to assume that distributions rolled over would have involved an affirmative election, and that the number of participants making affirmative elections will be largely unchanged. The number of mandatory lump sum distributions of \$1,001 to \$5,000, approximately 143,000 distributions, is assumed to represent an upper bound of the number of participants potentially affected by the automatic rollover provisions of Code section 401(a)(31)(B).

The cost of automatic rollovers has been adjusted to account for additional costs associated with rollovers of mandatory distributions of \$1,000 or less by eligible plans. Specifically, new section 2550.404a-2(d) of the regulation permits plans with a mandatory distribution provision that includes individual retirement accounts valued at \$1,000 or less, as described in section 411(a)(11) of the Code, to roll over the accounts into an individual retirement plan. Unlike the mandatory rollover provisions of EGTRRA, the decision to roll over smaller accounts under new paragraph (d) of the regulation is a voluntary one. The Department has conservatively assumed, for purposes of this analysis, that all eligible plans will take advantage of the option to roll over smaller accounts and has analyzed the costs and benefits of the regulation separately from those of the amendment. Using data from SIPP, Wave 7 Pension Benefits Module, the Department estimates that approximately 85,000 participants might fail to make an affirmative election for a mandatory distribution of \$1,000 or less. The total number of participants that might fail to make an affirmative election to roll over a mandatory distribution is 228,000 participants.

Finally, during 1997, the account balances with present values of accrued benefits ("accounts") of between \$1 and \$5,000 of an additional 133,000

participants were left in plans for reasons that are not known. Although there is some uncertainty with respect to this assumption, this number has been used here as a proxy for a number of participants that did not receive mandatory distributions because they were passive or non-responsive.

In the aggregate, the amount of automatic rollovers of mandatory distributions to individual retirement plans for 361,000 participants is approximately \$722 million per year, or an average of \$2,000 per participant. Only \$456 million of this total represents retirement savings that would not otherwise have been preserved, given that the \$266 million was already maintained in retirement plans for the 133,000 former participants that were unavailable or unresponsive.

Costs and fees will be incurred by pension plans in connection with automatic rollovers and the investments for individual retirement plans.

After the effective date of the amendment, plans that currently mandate immediate distributions for amounts not to exceed \$5,000 will, absent an affirmative election of a different alternative, make direct transfers of these distributions to an individual retirement plan. To implement this change, fiduciaries and their professional service providers will need to review the new requirements and select individual retirement plan providers and investment products. The amount of time required for this activity will vary, but based on 680,000 retirement plans and an assumed hourly rate of \$68, the aggregate cost of each hour is over \$46 million. An effort involving an average of 3 hours would result in an aggregate one-time cost of \$139 million. For this estimate we have conservatively assumed that all plans provide for such mandatory distributions and will need to take action to implement procedures for automatic rollovers to individual retirement plans. The proportion of pension plans that provide for such mandatory distributions is not known, but is believed, based on anecdotal evidence, to be very high. This total cost may be lessened to the extent that fewer plans will need to address the automatic rollover requirement, or that the assistance of service providers to multiple plans results in greater efficiency.

Finally, plans will incur costs in connection with the final safe harbor to modify summary plan descriptions (SPD) or provide a summary of material modifications (SMM). This cost is estimated to be about \$13 million. Two

commenters suggested that the cost of disclosing information about a plan's automatic rollover provisions in an SPD or SMM was higher than the Department had estimated. The Department's estimate includes the costs of a one-time modification to the SPD or preparation of an SMM, and mailing and materials. The estimate also takes into consideration the fact that plan administrators report making routine distributions of revised SPDs or SMMs on a regular basis. The Department believes that many plans will make the required disclosure along with disclosures made for other reasons. This is expected to have the effect of reducing distribution costs that would otherwise be associated with the disclosure requirement for the safe harbor. As such, the Department continues to believe that its original estimate of \$13 million is appropriate.

The amount of some mandatory distributions subject to the automatic rollover requirements of section 401(a)(31)(B) of the Code may be more than \$5,000. This can occur where the present value of the nonforfeitable accrued benefits immediately distributable includes additional funds attributable to prior rollover contributions (and the earnings thereon).

A large majority of 401(k) plan participants are in plans that accept rollover contributions, according to the Bureau of Labor Statistics. There is some evidence, however, that rollovers into qualified plans are infrequent, which suggests that the number of participants whose accounts include amounts attributable to prior rollover contributions may be small. The number of such participants that will eventually become the owners of an automatic rollover individual retirement plan will be further limited by a number of factors, on which no data are available. Some plans will not mandate distribution of accounts that include prior rollover contributions and therefore exceed \$5,000. Some accounts of participants with prior rollover contributions will accumulate more than \$5,000 of additional contributions, thereby becoming ineligible for mandatory distributions. Some participants whose accounts do not accumulate more than \$5,000 will affirmatively direct, upon leaving employment, the disposition of their accounts. Compared with other participants, those with prior rollover contributions may be more likely to accumulate more than \$5,000 from new contributions and more likely to affirmatively direct the disposition of their accounts.

The Department did not attempt to estimate the number or dollar amount of mandatory distributions eligible for relief under the final safe harbor regulation that may exceed \$5,000. Adequate data to support such estimates are not currently available. The Department believes it is probable that the number of mandatory distributions containing prior rollover contributions that will be subject to the automatic rollover requirement of section 401(a)(31)(B) of the Code will be small but the number of plans affected and the dollar amount of some of these mandatory distributions might be large.

The establishment and maintenance of individual retirement plans for automatic rollovers of mandatory distributions will generate costs to participants whose accounts have been rolled over. At the time of the proposal, it was assumed that, in the absence of guidance, most fees would be charged against individual retirement plans. Based on a range of typical establishment fees for comparable individual retirement plans, \$0 to \$10 per account, the annual establishment fees for rollovers arising from the regulation each year are estimated to range from a negligible amount to \$3.6 million, with a mid point of \$1.8 million per year. Annual maintenance fees, which typically range from \$7 to \$50, are estimated to range from \$2.5 million to \$18 million, with a mid-point estimate of \$10.3 million for individual retirement plans established in the first year. A comparison of the upper bounds for maintenance fees yields an additional \$6 million increase in fees for participants, also attributable to the additional 120,000 rollovers newly included in the regulation. Assuming that individual retirement plans would continue to be established at a constant rate of 361,000 plans per year and that no account holders assume control of their plans, at the midpoint, maintenance fees would continue to grow at a rate of \$10.3 million annually.

Although establishment and maintenance fees are relatively predictable based on comparable individual retirement plans available in the marketplace, the types of investment products available and the actual choices that may be made by fiduciaries are considered to be too variable to support a meaningful estimate of investment fees, termination charges, and surrender fees. However, with this interpretive guidance, fiduciaries and the regulated financial institutions will have increased certainty regarding costs, fees, and charges for individual retirement plans.

The total one-time cost to plans for the amendment to the Code is \$139 million. The upper bounds of ranges for establishment and maintenance costs under the regulation are estimated at \$21.6 million.

## 2. Benefits of the EGTRRA and the Regulation

The regulation will benefit fiduciaries by affording them greater assurance of compliance and reduced exposure to risk. Specificity as to the types of entities that may receive the rollovers, the investment choices, and the limitations on fees will lessen the time required to comply with the EGTRRA amendment. The substantive conditions of the safe harbor will benefit former participants by directing their retirement savings to individual retirement plans, providers, regulated financial institutions, and investment products that minimize risk and offer preservation of principal and liquidity. Certain regulated financial institutions will receive additional deposits having earnings potential.

Plans will benefit from administrative cost savings for those 133,000 accounts that previously remained in pension plans because participants were passive or non-responsive but are assumed to be rolled over under the amendment to the Code and the regulation. Ordinary administrative costs that typically range from \$45 to \$150 per participant will be saved when accounts are rolled over, reducing plan expenses under the amendment to the Code and the regulation by about \$6 million to \$20 million, or at a mid point, \$13 million per year, \$3.5 million of which is attributable to the regulation only. The cost savings realized in each year will continue to accumulate through the future years that the accounts would otherwise have remained in the pension plan.

The benefits of greater certainty for fiduciaries and protection of participants cannot be specifically quantified. By providing a safe harbor for plan fiduciaries that choose to roll over accounts, the Department has increased certainty concerning compliance with ERISA section 404(a) for fiduciaries that designate institutions and investment funds for rolled over accounts and expanded the opportunity for retirement savings for plan participants.

The regulation is, however, expected to reduce one-time startup administrative compliance costs to plans by as much as \$92 million by narrowing the range of individual retirement plan providers and investment products fiduciaries might

otherwise consider, assuming a savings of 2 of the 3 hours that compliance would otherwise require.

At the time of the proposal, the Department estimated that the EGTRRA amendment would provide 143,000 former participants with preserved retirement savings of about \$415 million and immediate tax savings of about \$112 million on an annual basis. (The additional 98,000 former participants who did not receive mandatory distributions because they were passive or non-responsive were not counted for purposes of estimates of preserved retirement savings and tax savings because their accounts were not distributed.) These estimates were considerably higher than those included in the Joint Committee on Taxation's (JCT) May 26, 2001 estimates of the budget effects for this provision of EGTRRA, which projected a revenue loss of about \$30 million per year. This revenue loss implied an aggregate preservation of retirement savings of about \$83 million per year. Because the reasons for this difference were unknown, the Department interpreted the JCT estimates and its own estimates as the endpoints of ranges, and presented the midpoints as estimates of ordinary income tax and penalty savings, and preserved retirement savings. These midpoints amounted to \$71 million and \$249 million, respectively.

The Department estimates that paragraph (d) of the regulation will provide an additional 85,000 former plan participants with tax savings and preserved retirement savings, such that the aggregate estimate of tax savings of the amendment and the regulation is \$123 million, and the aggregate estimate of preserved retirement savings is \$456 million. Because the regulation includes the provision for mandatory distributions of \$1,000 or less, the JCT estimates and Department's estimates for these values are no longer exactly comparable. However, in spite of the substantial differences in the two sets of estimates, the Department has continued to present midpoints between the two to illustrate the potential benefits of tax savings and preserved retirement savings. The benefits, expressed as midpoints, amount to \$77 million in tax savings, and \$270 million in preserved retirement savings. These savings for former participants and distributions of amounts previously retained in plans also represent increased deposits to regulated financial institutions.

For the estimated 8 percent of these accounts that were in defined benefit plans, a savings of approximately

\$202,000 would be realized from reduced funding risk and corresponding premium payments to the PBGC. This includes an additional \$53,200 that arises from the change to the regulation with respect to mandatory distributions of \$1,000 or less.

#### *Paperwork Reduction Act*

This Notice of Final Rulemaking is not subject to the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) because it does not contain a "collection of information" as defined in 44 U.S.C. 3502(3). It is expected that this final rule will result in a modification of retirement plan Summary Plan Descriptions, an information collection request approved separately under OMB control number 1210-0039. However, this modification is not considered to be substantive or material in the context of that information collection request as a whole. In addition, the methodology for calculating burden under the Paperwork Reduction Act for the Summary Plan Description takes into account a steady rate of change in Summary Plan Descriptions that is estimated to accommodate the change that would be made by this final rulemaking.

The Department has clarified section (c)(3) of the regulation by inserting that the agreement between a fiduciary and an individual retirement plan provider that provides for the distribution of rolled over funds must be in writing. The agreement, as previously stated in the proposal, must include a description of the rollover investment product, fees, and participants' rights. The Department understands that it is customary business practice for agreements related to the establishment of individual retirement plans to be set forth in writing and that no new burden is created by this requirement. As a result, the Department has not made a submission for OMB approval in connection with the regulation.

#### *Regulatory Flexibility Act*

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and which are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a final rule is not likely to have a significant economic impact on a substantial number of small entities, section 604 of the RFA requires that the agency present a final regulatory flexibility analysis at the time

of the publication of the notice of final rulemaking describing the impact of the rule on small entities. Small entities include small businesses, organizations and governmental jurisdictions.

For purposes of analysis under the RFA, the Employee Benefits Security Administration (EBSA) proposes to continue to consider a small entity to be an employee benefit plan with fewer than 100 participants. The basis of this definition is found in section 104(a)(2) of ERISA, which permits the Secretary of Labor to prescribe simplified annual reports for pension plans that cover fewer than 100 participants. Under section 104(a)(3), the Secretary may also provide for exemptions or simplified annual reporting and disclosure for welfare benefit plans. Pursuant to the authority of section 104(a)(3), the Department has previously issued at 29 CFR 2520.104-20, 2520.104-21, 2520.104-41, 2520.104-46 and 2520.104b-10 certain simplified reporting provisions and limited exemptions from reporting and disclosure requirements for small plans, including unfunded or insured welfare plans covering fewer than 100 participants and which satisfy certain other requirements.

Further, while some large employers may have small plans, in general, small employers maintain most small plans. Thus, EBSA believes that assessing the impact of this proposed rule on small plans is an appropriate substitute for evaluating the effect on small entities. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business which is based on size standards promulgated by the Small Business Administration (SBA) (13 CFR 121.201) pursuant to the Small Business Act (15 U.S.C. 631 *et seq.*). EBSA therefore requested comments on the appropriateness of the size standard used in evaluating the impact of the proposal on small entities, but received none.

EBSA has determined that this rule will not have a significant economic impact on a substantial number of small entities. In support of this determination, and in an effort to provide a sound basis for this conclusion, EBSA has prepared the following final regulatory flexibility analysis.

Section 657(c)(2)(A) of EGTRRA directed the Department to issue regulations providing safe harbors under which a plan administrator's designation of an institution to receive automatic rollovers of mandatory distributions pursuant to section 401(a)(31)(B) of the Code and the initial

investment choice for the rolled-over funds would be deemed to satisfy the fiduciary responsibility provisions of section 404(a) of ERISA. This EGTRRA provision further provided that the Code provisions requiring automatic rollovers of certain mandatory distributions to individual retirement plans would not become effective until the Department issued safe harbor regulations. Before issuing a proposed regulation, the Department requested comments on the potential design of the safe harbor.

The conditions set forth in this regulation are intended to satisfy the EGTRRA requirement that the Department prescribe regulations providing for safe harbors, while meeting the objectives of offering greater certainty to fiduciaries concerning their compliance with the requirements of ERISA section 404(a), and of preserving assets of former plan participants for retirement income purposes. In describing the financial institutions, investment products, and fee arrangements that fall within the safe harbor, the Department has attempted to strike a balance between the interests of fiduciaries, individual retirement plan providers, and the investment goal of preserving principal.

The regulation will impact small plans that include provisions for the mandatory distribution of accounts with a value not greater than \$5,000. It has been assumed for the purposes of this analysis that all plans include such provisions, although some may not. On this basis, it is expected that the proposal will affect 611,800 small plans. The proportion of the total of 361,000 participants estimated to be affected annually by the amendment to Code section 401(a)(31)(B) and paragraph (d) of the regulation that are in small plans is not known. Similarly, there are no available data on the number of participants that will separate from employment with account balances of more than \$5,000 (because of prior rollover contributions) that may be, depending on the provisions of the distributing plans, automatically rolled over under EGTRRA. It is assumed that all 611,800 small plans will need to address compliance with the Code amendment and will choose to comply with new § 2550.404a-2(d).

As described above, the costs and benefits of the Code amendment and safe harbor proposal are distinguishable, and have been estimated separately. As also noted, the regulation is expected to substantially reduce the cost of compliance with the Code amendment. The initial cost of the Code amendment for small plans is expected to be about \$124 million. The one-time savings from

the final regulation is estimated at about \$83 million for small plans compared with \$9 million for large plans, due to the significantly larger number of small plans. The condition of the safe harbor requiring disclosure of specific information in a summary plan description or summary of material modification is expected to result in costs to small plans of about \$11 million. Preparation of this information is in most cases accomplished by professionals that provide services to employee benefit plans. Where fiduciaries prepare these materials themselves, it is assumed that persons at the professional level of budget analysts or financial managers will complete the necessary work.

The benefits of greater certainty afforded fiduciaries by the safe harbor are substantial but cannot be specifically quantified.

Prior to publication of this regulation, the Department published an RFI requesting comments and suggestions from the general public on developing guidelines to assist fiduciaries in selecting institutions and investment products for individual retirement plans. The Department specifically requested in the RFI that commenters, "address the anticipated annual impact of any proposals on small businesses and small plans (plans with fewer than 100 participants)." The Department received three comments that pertained specifically to small plans, the first of which cautioned that plan sponsors would be deterred from sponsoring plans with a mandatory distribution provision by placement of any additional burdens on them. Another comment indicated that, because of technological improvements, the burden on small plans would be manageable. Finally, a third commenter noted that annual costs would not be any higher for small plans. The Department received no specific comments on the impact of the proposal on small plans.

To the Department's knowledge, there are no Federal regulations that might duplicate, overlap, or conflict with the regulation for safe harbors under section 404(a) of ERISA.

#### *Congressional Review Act*

The notice of final rulemaking being issued here is subject to the provisions of the Congressional Review Act provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 *et seq.*) and has been transmitted to the Congress and the Comptroller General for review.

#### *Unfunded Mandates Reform Act*

Pursuant to provisions of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4), this rule does not include any Federal mandate that may result in expenditures by State, local, or tribal governments, or the private sector, which may impose an annual burden of \$100 or more.

#### *Federalism Statement*

Executive Order 13132 (August 4, 1999) outlines fundamental principles of federalism and requires the adherence to specific criteria by Federal agencies in the process of their formulation and implementation of policies that have substantial direct effects on the States, the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. This final rule would not have federalism implications because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated that are not pertinent here, that the provisions of Titles I and IV of ERISA supersede any and all laws of the States as they relate to any employee benefit plan covered under ERISA. The requirements implemented in this final rule do not alter the fundamental provisions of the statute with respect to employee benefit plans, and as such would have no implications for the States or the relationship or distribution of power between the national government and the States.

#### **List of Subjects in 29 CFR Part 2550**

Employee benefit plans, Employee Retirement Income Security Act, Employee stock ownership plans, Exemptions, Fiduciaries, Investments, Investments foreign, Party in interest, Pensions, Pension and Welfare Benefit Programs Office, Prohibited transactions, Real estate, Securities, Surety bonds, Trusts and Trustees.

■ For the reasons set forth in the preamble, the Department amends subchapter F, part 2550 of Title 29 of the Code of Federal Regulations as follows:

#### **Subchapter F—Fiduciary Responsibility Under the Employee Retirement Income Security Act of 1974**

#### **PART 2550—RULES AND REGULATIONS FOR FIDUCIARY RESPONSIBILITY**

■ 1. The authority citation for part 2550 is revised to read as follows:

**Authority:** 29 U.S.C. 1135; and Secretary of Labor's Order No. 1-2003, 68 FR 5374 (Feb. 3, 2003). Sec. 2550.401b-1 also issued under sec. 102, Reorganization Plan No. 4 of 1978, 43 FR 47713, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, E.O. 12108, 44 FR 1065, 3 CFR, 1978 Comp. p. 275. Sec. 2550.401c-1 also issued under 29 U.S.C. 1101. Sec. 2550.404c-1 also issued under 29 U.S.C. 1104. Sec. 2550.407c-3 also issued under 29 U.S.C. 1107. Sec. 2550.404a-2 also issued under 26 U.S.C. 401 note (sec. 657, Pub. L. 107-16, 115 Stat. 38). Sec. 2550.408b-1 also issued under 29 U.S.C. 1108(b)(1) and sec. 102, Reorganization Plan No. 4 of 1978, 43 FR 47713, 3 CFR, 1978 Comp. p. 332, effective Dec. 31, 1978, E.O. 12108, 44 FR 1065, 3 CFR, 1978 Comp. p. 275. Sec. 2550.412-1 also issued under 29 U.S.C. 1112.

■ 2. The following new section is added to part 2550 to read as follows:

#### **§ 2550.404a-2 Safe harbor for automatic rollovers to individual retirement plans.**

(a) *In general.* (1) Pursuant to section 657(c) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16, June 7, 2001, 115 Stat. 38, this section provides a safe harbor under which a fiduciary of an employee pension benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended (the Act), 29 U.S.C. 1001 *et seq.*, will be deemed to have satisfied his or her fiduciary duties under section 404(a) of the Act in connection with an automatic rollover of a mandatory distribution described in section 401(a)(31)(B) of the Internal Revenue Code of 1986, as amended (the Code). This section also provides a safe harbor for certain other mandatory distributions not described in section 401(a)(31)(B) of the Code.

(2) The standards set forth in this section apply solely for purposes of determining whether a fiduciary meets the requirements of this safe harbor. Such standards are not intended to be the exclusive means by which a fiduciary might satisfy his or her responsibilities under the Act with respect to rollovers of mandatory distributions described in paragraphs (c) and (d) of this section.

(b) *Safe harbor.* A fiduciary that meets the conditions of paragraph (c) or paragraph (d) of this section is deemed to have satisfied his or her duties under section 404(a) of the Act with respect to

both the selection of an individual retirement plan provider and the investment of funds in connection with the rollover of mandatory distributions described in those paragraphs to an individual retirement plan, within the meaning of section 7701(a)(37) of the Code.

(c) *Conditions.* With respect to an automatic rollover of a mandatory distribution described in section 401(a)(31)(B) of the Code, a fiduciary shall qualify for the safe harbor described in paragraph (b) of this section if:

(1) The present value of the nonforfeitable accrued benefit, as determined under section 411(a)(11) of the Code, does not exceed the maximum amount under section 401(a)(31)(B) of the Code;

(2) The mandatory distribution is to an individual retirement plan within the meaning of section 7701(a)(37) of the Code;

(3) In connection with the distribution of rolled-over funds to an individual retirement plan, the fiduciary enters into a written agreement with an individual retirement plan provider that provides:

(i) The rolled-over funds shall be invested in an investment product designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity;

(ii) For purposes of paragraph (c)(3)(i) of this section, the investment product selected for the rolled-over funds shall seek to maintain, over the term of the investment, the dollar value that is equal to the amount invested in the product by the individual retirement plan;

(iii) The investment product selected for the rolled-over funds shall be offered by a state or federally regulated financial institution, which shall be:

bank or savings association, the deposits of which are insured by the Federal Deposit Insurance Corporation; a credit union, the member accounts of which are insured within the meaning of section 101(7) of the Federal Credit Union Act; an insurance company, the products of which are protected by State guaranty associations; or an investment company registered under the Investment Company Act of 1940;

(iv) All fees and expenses attendant to an individual retirement plan, including investments of such plan, (e.g., establishment charges, maintenance fees, investment expenses, termination costs and surrender charges) shall not exceed the fees and expenses charged by the individual retirement plan provider for comparable individual retirement plans established for reasons other than the receipt of a rollover distribution subject to the provisions of section 401(a)(31)(B) of the Code; and

(v) The participant on whose behalf the fiduciary makes an automatic rollover shall have the right to enforce the terms of the contractual agreement establishing the individual retirement plan, with regard to his or her rolled-over funds, against the individual retirement plan provider.

(4) Participants have been furnished a summary plan description, or a summary of material modifications, that describes the plan's automatic rollover provisions effectuating the requirements of section 401(a)(31)(B) of the Code, including an explanation that the mandatory distribution will be invested in an investment product designed to preserve principal and provide a reasonable rate of return and liquidity, a statement indicating how fees and expenses attendant to the individual retirement plan will be allocated (i.e., the extent to which expenses will be borne by the account holder alone or shared with the distributing plan or

plan sponsor), and the name, address and phone number of a plan contact (to the extent not otherwise provided in the summary plan description or summary of material modifications) for further information concerning the plan's automatic rollover provisions, the individual retirement plan provider and the fees and expenses attendant to the individual retirement plan; and

(5) Both the fiduciary's selection of an individual retirement plan and the investment of funds would not result in a prohibited transaction under section 406 of the Act, unless such actions are exempted from the prohibited transaction provisions by a prohibited transaction exemption issued pursuant to section 408(a) of the Act.

(d) *Mandatory distributions of \$1,000 or less.* A fiduciary shall qualify for the protection afforded by the safe harbor described in paragraph (b) of this section with respect to a mandatory distribution of one thousand dollars (\$1,000) or less described in section 411(a)(11) of the Code, provided there is no affirmative distribution election by the participant and the fiduciary makes a rollover distribution of such amount into an individual retirement plan on behalf of such participant in accordance with the conditions described in paragraph (c) of this section, without regard to the fact that such rollover is not described in section 401(a)(31)(B) of the Code.

(e) *Effective date.* This section shall be effective and shall apply to any rollover of a mandatory distribution made on or after March 28, 2005.

Signed at Washington, DC, this 20th day of September, 2004.

**Ann L. Combs,**

*Assistant Secretary, Employee Benefits Security Administration.*

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