



# Employee Benefits Law Action Memo

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## MOST RETIREMENT PLANS MUST COMPLY WITH NEW AUTOMATIC ROLLOVER RULES BY MARCH 28, 2005

Effective March 28, 2005, most retirement plans that provide for mandatory cash-out distributions will be required to implement new automatic rollover procedures that were added by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). On September 28, 2004, the United States Department of Labor published final regulations regarding the automatic rollover of cash-out distributions from retirement plans into individual retirement accounts ("IRAs"). The final regulations provide retirement plan fiduciaries with a regulatory "safe harbor" for satisfying their fiduciary responsibilities in connection with such rollovers.

### EGTRRA Automatic Rollover Rules

Many retirement plans provide that, if the present value of a participant's benefit under the plan is \$5,000 or less upon termination of employment, then the plan will automatically distribute the participant's benefit in a single sum payment, without the participant's consent. This is known as an automatic or mandatory cash-out provision. While a participant generally must be given the opportunity to roll the distribution into another retirement plan or IRA, the participant's benefit is distributed directly to the participant, if the participant does not make an affirmative rollover election. In an effort to promote retirement savings, Congress, as part of EGTRRA, amended the rollover rules to require that mandatory cash-outs of amounts between \$1,001 and \$5,000 be automatically rolled into an IRA, unless the participant affirmatively makes a different election.

Thus, under EGTRRA, the plan administrator must select an IRA provider and make an initial election regarding the investment of the assets rolled into the IRA in connection with the automatic rollover of a cash-out distribution. In recognition of the fact that a plan administrator could be subject to fiduciary liability under the Employee Retirement Income Security Act ("ERISA") in connection with such decisions, Congress directed the U.S. Department of Labor to issue regulations regarding fiduciary responsibilities in connection with automatic rollovers. In response to this mandate, the final regulations issued by the U.S. Department of Labor on September 28, 2004 include a fiduciary safe harbor. If a fiduciary complies with the safe harbor, the fiduciary generally will be protected from claims of breach of fiduciary duty regarding the selection of the IRA provider and the initial investment choice.

### Safe Harbor Requirements

A fiduciary will be deemed to have satisfied his or her duties under ERISA with respect to selecting an automatic rollover IRA provider and selecting an initial investment option if the following requirements are met:

1. *Rollover Amount.* The amount rolled over to an IRA may not exceed the amount that can be distributed without the participant's consent under Section 411(a)(11) of the Internal Revenue Code. Currently, this limit is \$5,000. Although EGTRRA requires automatic rollovers only for cash-out distributions

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that exceed \$1,000, the safe harbor provisions in the final regulations apply to all involuntary cash-out distributions of \$5,000 or less, including those in amounts of \$1,000 or less.

2. *IRA Requirements.* The rollover must be made to a qualified individual retirement account or individual retirement annuity sponsored by a state or federally regulated financial institution. The IRA must be opened in the participant's name.
3. *Written Agreement.* The plan sponsor and the IRA trustee or custodian must enter into a written agreement that specifically provides for the investment of the rollover funds and describes the fees and expenses associated with the IRA. While the final regulations provide that the written agreement with the IRA provider must be established by the plan fiduciary on behalf of the plan participant, the agreement must be enforceable by the participant. The plan fiduciary will have no duty to monitor the IRA provider's compliance with the agreement after its initial establishment.
4. *Investments.* The rollover assets must be invested in products designed to preserve principal and provide a reasonable rate of return. Products that meet these requirements generally include, but are not necessarily limited to, money market funds, interest-bearing savings accounts and certificates of deposit. The investment product must be offered by a state or federally regulated financial institution, such as a bank, credit union, insurance company or investment company.
5. *Fees and Expenses.* The amounts charged for the set-up and maintenance of the automatic rollover IRA may not exceed comparable fees and expenses charged by the IRA provider for rollover IRAs established in other circumstances (i.e., non-automatic rollovers).
6. *Disclosure.* Prior to implementation of the new automatic rollover procedures, participants and beneficiaries must be provided with a summary plan description or summary of material modifications describing the automatic rollover process, how automatic rollovers will be invested, the fees and expenses associated with the IRA, and other relevant information.
7. *No prohibited transaction.* When selecting the IRA provider, the plan fiduciary must not engage in a prohibited transaction. A class prohibited transaction exemption was issued simultaneously with the final regulations that permits certain plan sponsors to select their own products and services for automatic rollovers from their own retirement plans.

## Immediate Action Required

Plan sponsors that wish to continue making mandatory cash-out distributions should begin to take steps to ensure compliance by March 28, 2005. In particular, the plan sponsor will need to select an IRA provider, make an initial investment selection and enter into a written agreement with the IRA provider. Plan procedures governing the automatic rollover process will need to be developed and participants must be provided with the required disclosures. The Internal Revenue Service is expected to issue further guidance regarding the implementation of these rules in the near future. This guidance will likely include sample language that a plan sponsor may adopt to amend its plans to comply with the new rules and guidance regarding when such an amendment must be adopted.

Alternatively, a plan sponsor that does not wish to comply with the new rules might consider amending its plan to lower its mandatory cash-out limit to \$1,000 or less, or to eliminate mandatory cash-outs altogether. However, the plan sponsor should consider the administrative costs and fiduciary issues associated with retaining small account balances. A plan sponsor that wishes to limit the application of the mandatory cash-out rules should amend its plans prior to March 28, 2005.

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