

Employee Benefits Briefing

A bulletin designed to keep clients and other friends informed on employee benefits law matters

October 2004

MANDATORY ROLLOVERS

The Department of Labor issued on September 28, 2004 a final safe harbor rule for mandatory rollovers from retirement plans subject to Title I of ERISA. The safe harbor implements EGTRRA's amendment to the rollover rules in IRC section 401(a)(31)(B) requiring rollover of distributions in certain cases. The safe harbor rule applies to plans that "cash out" participant accounts or accrued benefits with a value of over \$1,000 up to \$5,000. Absent participant direction to the contrary, a fiduciary will be required to roll over the amount to an individual retirement account (IRA). If the requirements of the safe harbor are met, the fiduciary will be deemed to have satisfied his or her fiduciary duties under ERISA with respect to both selection of the IRA provider and investment of the funds.

The safe harbor requires that the following actions be taken:

Written Agreement

- The fiduciary and the IRA provider must enter into a written contract that provides:
 - The rolled-over funds will be invested in an investment product that is designed to preserve principal and has a reasonable rate of return—for example, a money market or stable value fund or a bank certificate of deposit. Permissible investments include only those offered by a federally insured bank, savings

association or credit union, a state regulated insurance company or a 1940 Act investment company.

- The fee charged by the IRA provider (including investment expenses and any surrender charges) cannot exceed the same fees charged by the provider for comparable non-automatic rollover accounts.
- The participant has third-party rights under the contract to enforce its terms against the IRA provider.

Notice to the Participant (can be provided in an SPD or SMM)

- Provide an explanation of the plan's automatic rollover provisions by informing participants that upon a distributable event vested benefits of \$1,000 to \$5,000 will be rolled over to an IRA absent participant direction to the contrary.
- Describe the type of investment vehicle that will be used.
- State who will pay the IRA fees (normally the participant by a charge to the IRA account).
- Include plan contact information for any questions a participant may have.

Prohibited Transaction Relief

- The Department of Labor issued, contemporaneously with the automatic rollover final regulations, a prohibited transaction exemption (PTE 2004-16) which provides that a plan sponsor (or its affiliate) can act as the IRA provider under the automatic rollover safe harbor rules. This permits plans sponsored by financial institutions offering IRAs to the general public to establish rollover accounts for their employees as well.
- The class exemption requires that all of the safe harbor requirements set forth above be met, as well as requiring that:
 - The rate of return for the IRA be at least as favorable as the return for non-automatic rollover accounts.
 - No sales commissions be paid by the IRA on its investments.
 - Fees and expenses for the IRA (in addition to the safe harbor requirements) be charged only against income (except for any establishment charges) and not be in excess of “reasonable compensation” under IRS rules.
 - The participant have the right to transfer the IRA to a different investment product of the plan sponsor or to a different IRA provider without penalty to the rollover’s principal amount.
 - Records for automatic rollover accounts be maintained for six years from the date of transfer from the plan.

EFFECTIVE DATE

The final regulations are not effective until March 28, 2005; however, they may be relied upon in good faith immediately.

PLAN AMENDMENTS

Employers that sponsor plans with cash-out provisions will need to amend their plans by the filing deadline for the first tax year ending after March 28, 2005 (including extensions). The amendment must provide for mandatory rollover of amounts between \$1,000 (or less if desired by the employer) and \$5,000 to an IRA unless the participant elects to receive the distribution directly or to roll the amount over to another eligible retirement plan.

Alternatively, the amendment could eliminate the cash-out of accounts or benefits in excess of \$1,000, but this may not be desirable since it will likely increase the number of accounts that belong to missing participants.

You should contact the Vedder, Price attorney you work with directly if you need assistance or have any questions regarding the automatic rollover rules.

LOCATING MISSING PARTICIPANTS

Effective September 30, 2004, the Department of Labor issued guidance regarding a fiduciary's responsibility to locate missing participants. This is often a problem when a plan is being terminated, but the guidance may be informative for all plans in handling this problem. When efforts to locate participants by first-class mail or by electronic notification are unanswered, fiduciaries must conduct a search using prescribed methods, taking into account the size of the participant's account balance and the cost of the search method. After exhausting all appropriate search methods, certain distribution options are available to terminating plans.

SEARCH METHODS

1. *Certified Mail.*
2. *Related Plan Records.* Check the other plan records (e.g., health plan) of the employer or recordkeeper for current participant information.
3. *Designated Plan Beneficiary.* Attempt to identify and contact any person designated as the individual's beneficiary.
4. *Letter-forwarding Service.* The Internal Revenue Service and the Social Security Administration both provide a service to locate missing participants by using information in their databases. They will attempt to forward a letter from the fiduciary if given the missing participant's social security number.
5. *Optional Methods.* Other options include (1) the Internet, (2) commercial locator services and (3) credit reporting agencies.

DISTRIBUTION OPTIONS

In order to complete a plan termination, a plan administrator should consider the following options:

Individual Retirement Account

Distributing benefits of missing participants into an individual retirement account (IRA) is the preferred distribution option. This can be done in the same manner as the mandatory rollovers for cash-out distributions.

Federally Insured Bank Accounts

If the fiduciary cannot locate an individual retirement plan provider willing to accept the rollover distribution, the fiduciary may establish an interest-bearing, federally insured bank account in the name of the missing participant.

State Unclaimed Property Funds

Alternatively, the fiduciary may consider transferring missing participants' account balances to state unclaimed property funds in the state of a participant's last known residence or work location. Some states accept such distributions on behalf of missing participants and often provide searchable Internet databases that list names of property owners.

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The Employee Benefits Group

Vedder Price has one of the nation's largest employee benefits practices, with ongoing responsibility for the design, administration and legal compliance of pension, profit sharing and welfare benefit plans with aggregate assets of several billion dollars. Our employee benefits lawyers also have been involved in major litigation on behalf of benefit plans and their sponsors. Our clients include large national corporations, smaller professional and business corporations, multiemployer trust funds, investment managers and other plan fiduciaries.

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