



## Information Release

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### Automatic Rollovers Required Beginning March 28, 2005

Many retirement plans provide that a terminating participant's vested benefit will be cashed out automatically if it is valued at no more than \$5,000. Such cash outs may be made without the participant's consent.

The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) added a requirement that mandatory cash outs of amounts between \$1,000 and \$5,000 **must** be rolled over automatically to an individual retirement account or individual retirement annuity unless the participant affirmatively elects otherwise.

The selection of a financial institution to receive such automatic rollovers and the initial investment of the amounts rolled over are fiduciary acts. To limit the exposure of plan fiduciaries to liability for these acts, the Department of Labor (DOL) has issued safe harbor rules for fiduciaries. Compliance with the safe harbor rules means that the plan fiduciary will not incur liability with respect to the selection of the individual retirement plan provider nor the initial investment of assets rolled over.

Both the safe harbor and the automatic rollover requirement become effective March 28, 2005. Many retirement plans will need to take steps to comply with the new rollover requirement and to satisfy the rules for the fiduciary protection offered by the safe harbor.

#### Automatic Rollover Requirement

The amount of the terminating participant's vested benefit must be \$5,000 or less. In determining whether a benefit exceeds the \$5,000 threshold, plans can ignore amounts attributable to prior rollover contributions. While not required to do so, a plan may provide for the automatic rollover of vested benefits in amounts of \$1,000 or less and still receive the protection provided by the fiduciary safe harbor.

#### Fiduciary Safe Harbor Requirements

In order to qualify for the protection of the fiduciary safe harbor, a plan sponsor must comply with the following rules:

## **Individual Retirement Plans**

The automatic rollover must be made to an “individual retirement plan”. These include individual retirement accounts and individual retirement annuities. The custodians of these plans must be banks, insurance companies and other registered financial institutions. A plan can choose one or more individual retirement providers to receive automatic rollovers.

## **Written Agreement**

The plan fiduciary must have a written agreement with its chosen individual retirement plan provider(s) that specifically addresses the investment of rollover amounts and the related fees and expenses. Once the rollover is completed, the responsibility of the plan fiduciary ends. The plan participant, now the IRA owner, is entitled to enforce the terms of the agreement with the individual retirement plan provider.

## **Investment Products**

Benefits that are automatically rolled over must be invested in products designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed. The investment product must seek to maintain, over the term of the investment, a dollar value equal to the amount invested by the individual retirement plan. The investment products must be offered by state or federally regulated financial institutions, including most FDIC-insured banks, insured credit unions, insurance companies and registered investment companies. The DOL has said that permissible investments may include:

- ✓ Money market funds maintained by registered investment companies;
- ✓ Interest-bearing savings accounts and certificates of deposit of banks or similar financial institutions; and
- ✓ “Stable value products” issued by regulated financial institutions.

## **Fees**

Fees and expenses cannot exceed what would ordinarily be charged for comparable individual retirement plans established for non-automatic rollover IRAs.

## **Required Disclosure**

In advance of an automatic rollover, participants must receive a Summary Plan Description or a Summary of Material Modifications that explains the plan’s procedures for automatic rollovers, including a description of the investment product and the method used to determine the fees applicable to a participant’s account.

In addition, the disclosure must identify a contact person from whom the participant can obtain more information about the plan’s designated individual retirement plan provider(s) and the fees associated with the rollover accounts.

## Prohibited Transaction Class Exemptions

The DOL has issued a prohibited transaction class exemption that allows banks and other financial institutions that maintain retirement plans for their own employees to allow them to use their own IRA products and investments. In these cases, there are additional restrictions on the fees that may be charged to participants.

### Effective Date

The fiduciary relief set forth in this final DOL regulation will apply to any rollover of mandatory distributions made on or after March 28, 2005. Prior to that date, plan fiduciaries may rely in good faith on the safe harbor guidelines when selecting an institution to receive rollovers of mandatory cash out distributions or making the initial investment selection for those future rollovers. (Note, however, that the class exemption for banks and other financial institutions to choose their own individual retirement account products for their employees is effective on March 28, 2005 and may *not* be relied upon for prohibited transaction relief before that date.)

### What You Must Do

In order to comply with the automatic rollover requirements, plan sponsors will need to:

- ✓ Identify IRA providers and enter into written agreements with them.
- ✓ Sign a brief plan amendment before the end of the first plan year ending after March 28, 2005.
- ✓ Prepare new Summary Plan Descriptions or a Summary of Material Modifications describing the automatic rollover provisions and conforming to the new fiduciary safe harbor.
- ✓ Revise termination notices

All of these steps must be accomplished before processing any cash outs on or after March 28, 2005. If all of these steps cannot be completed by March 28, 2005, a plan can postpone mandatory distributions as long as they are made prior to December 31, 2005.

If you have any questions or need any assistance in complying with the new requirements, please contact your Kravitz consultant.

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