

January 31, 2005

THE AUTOMATIC ROLLOVER RULES

The new automatic rollover rules for tax-qualified retirement plans, effective March 28, 2005, require that, absent a plan participant's affirmative election, certain mandatory cash-out distributions of more than \$1,000 but not greater than \$5,000 (ignoring the value of a participant's rollover contributions made to the plan) must be directly transferred to an individual retirement account or annuity ("IRA") established by the plan on the participant's behalf. Church and governmental plans will not be subject to these rules until 2006, or later.


The Internal Revenue Service ("IRS") recently published Notice 2005-5 (the "Notice") which describes (i) the automatic rollover, (ii) the notification that must be provided to participants or beneficiaries, and (iii) the plan amendment that must be made to comply with the new rules. A mandatory cash-out distribution to which the new automatic rollover rules apply is any distribution made to a participant without his or her consent prior to the participant attaining the age of 62 or, if later, normal retirement age under the plan. Certain distributions, such as required minimum distributions or distributions to a child, spouse or former spouse, are not treated as mandatory cash-out distributions. If the new automatic rollover rules apply to a distribution, the entire amount in the plan must be transferred to an IRA, including any rollover contributions.

The Notice requires (i) amendments of plan documents, (ii) employee communications and (iii) contracts with individual retirement plan providers. The plan document must be amended by the end of the first plan year ending after March 28, 2005 (December 31, 2005 for calendar year plans); however, the plan generally must be operated in accordance with the new automatic rollover rules on and after March 28, 2005. There is a grace period until December 31, 2005, during which mandatory distributions may be suspended, if the plan has insufficient administrative procedures to comply with the new rules, as long as the mandatory cash-out distributions are processed on or before December 31, 2005.

A description of the plan's automatic rollover procedures must be distributed to the participant prior to receiving a distribution. This notice must identify the trustee or issuer of the IRA and may be included with the plan's standard distribution tax notice. The plan administrator is permitted to execute the documents necessary to set up the IRA on a participant's behalf.

The Department of Labor ("DOL") published final regulations describing a safe harbor which, if met, will provide fiduciary protection with respect to two aspects of the automatic rollover process: (i) the selection of the institution that will provide the IRA, and (ii) the investment selections of the IRA. Safe harbor relief under the DOL regulations is conditioned on satisfaction of the following conditions:

- The mandatory distribution must be directed to an IRA meeting certain statutory requirements.
- Plan fiduciaries must enter into a written agreement with the chosen IRA provider that addresses among other items, the investment of rolled-over funds and the fees and expenses attendant to the IRA.



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- The rolled-over funds must be invested in investment products that are designed to minimize risk, preserve assets for retirement, and maintain liquidity, such as money market funds, interest-bearing savings accounts, bank certificates of deposit, and stable value products issued by regulated financial institutions.
- Fees and expenses assessed by the IRA provider cannot exceed the amount charged by the provider for comparable IRAs established for rollover distributions other than automatic rollovers.
- The Summary Plan Description (“SPD”) or a Summary of Material Modifications (“SMM”) must be modified by March 28, 2005, or prior to the first automatic rollover, if later. The SPD or SMM must describe the investment products in which rolled-over funds will be invested, and the allocation of fees and expenses attendant to the IRA and must identify a plan contact who can provide further information regarding the plan’s procedures, the IRA, and required fees.

At present, plans may have problems locating IRA providers who are willing or able to comply with the requirements for automatic rollovers. Other plans may wish to avoid the administrative cost and complications imposed by the new rollover rules. These new rules can be avoided altogether by amending the plan to either (i) completely eliminate mandatory cash-out distributions or (ii) require mandatory cash-out distributions only for amounts of \$1,000 or less. However, eliminating or reducing the cash-out dollar limit may increase the administrative costs of the plan since fewer participants would be automatically cashed-out upon termination of employment or another distribution event. Although the Notice provides a grace period during which a plan may be amended to comply with the automatic rollover rules, it is unclear whether any grace period applies to plans for which mandatory distributions are being reduced or eliminated.

If you have any questions regarding these automatic rollover rules or other benefits matters, please call any of the attorneys listed below.

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