

# Automatic Rollovers

PEBA Meeting  
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# Automatic Cashouts

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## **Brief History:**

REA 1984: Allows (doesn't require) plan to provide for "mandatory distribution" or "cashout" for terminated participants whose vested account balance/accrued benefit is not greater than \$3,500, without participant consent. Raised to \$5,000 by Taxpayer Relief Act of 1997.

EGTRRA, 2001: The IRC is amended to require mandatory distributions in excess of \$1,000 to be rolled over into an IRA selected by the plan administrator, absent an election by a participant.

However, the effective date of the EGTRRA changes was deferred until the DOL issued regulations providing a "safe harbor" from fiduciary liability under ERISA Section 404(a).

September 2004: the DOL issues final safe harbor regulations, with an effective date of March 28, 2005.

However, the final DOL regulations acknowledge the need for additional IRS guidance. IRS issues Notice 2005-5 in December 2004, which clarifies various matters and provides a model amendment.



# Automatic Rollovers - Three Options

Plan administrators (often the plan sponsor or a committee with fiduciary responsibility) have the following options:

- Adopt Automatic Rollover rules, cashouts greater than \$1,000 and not greater than \$5,000
- Eliminate involuntary cashouts of amounts greater than \$1,000
- Eliminate the cashout option

**Decisions required by March 28, 2005,**

However....



# Sponsor Can Buy a Little More Time for Implementation

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Per recent IRS guidance (Notice 2005-5), amendment of plan to provide for automatic rollovers and actual automatic rollovers can be postponed until end of first PY ending on or after March 28, 2005. **(CAUTION: Can be earlier than December 31, 2005, if not a calendar year plan.)**

- Available if plan adopts Automatic Rollover rules or if amended to reduce threshold to \$1,000
- Can delay implementation of automatic rollovers until as late as December 31, 2005, as long as distributions are processed by December 31, 2005 and amendments signed end of PY above
- All types of plans are eligible to delay implementation
- IRS provided a model amendment that can be used by prototype users (no IRS model amendment for reducing threshold)
- Effect of delay is to suspend processing of cashouts otherwise subject to new rule
- Does **not** suspend other cashouts (not subject to new rules) – may need to review forms and notices



# What Types of Plans Must Comply?

- All qualified plans, including DC Plans (401(k), profit sharing etc)
- Governmental Plans as described in Code Section 414(s) and governmental deferred compensation plans under Section 457(b)
- Church plans under Code Section 414(e)
  - Just like other categories, If they have mandatory cashouts without participant consent
- Code Section 403(b) plans for tax-exempt organizations and public schools



# Automatic Rollover Rules

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## Overview:

- Qualified plan is affected if plan makes involuntary lump sum cashouts over \$1,000
- Practical effect: cashouts (>\$1,000) w/o an affirmative participant election regarding “cash or rollover”
- Effective March 28, 2005, default payment form for such cashouts must be a direct rollover to IRA
- Guidance permits operational delay (until 12/31/2005)
- Does not apply to death benefits, QDRO payments, scheduled MRD's
- Does not apply to post-NRA payments (if NRA  $\geq$  62)



# Automatic Rollover

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- New rules apply to involuntary cashouts greater than \$1,000 and not greater than \$5,000 when terminated participant makes no election to receive benefits
  - Affects both DB and DC plans
- Determining the value of a participants account
  - Automatic Rollover, \$1,000 threshold- Plan must include amounts that have been rolled over into a participants account
  - Automatic Rollover, \$5,000 threshold- Plan is permitted to exclude amounts that have been rolled over into a participants account



# Automatic Rollover

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- Effective for distributions made on or after March 28, 2005
  - May affects IRC “402(f)” special tax notices sent after February 26, 2005, regardless of compliance strategy taken
    - IRS has not stated when it will provide new model 402(f) Notices
    - Revisions may be necessary before new model notices are issued



# Automatic Rollover - Safe Harbor

- Default is direct rollover to IRA selected by plan administrator
  - Rather than cash, which would be subject to withholding
  - Unless cash or another IRA affirmatively selected by a participant
- Safe Harbor regarding selection by plan administrator
  - Per final DOL regulations, fiduciaries can meet ERISA fiduciary responsibility for IRA selection (and avoid any ongoing duty of monitoring) by selecting a “safe harbor” IRA that meets certain conditions
    - Investments effectively limited to fixed income
    - Fees are “comparable” to fees of similar IRA rollover products
    - Participants are provided a SPD or SMM that describes the IRA product BEFORE the rollover is made
      - Need not be provided with 402(f) notice, but doing so may become best practice



# Automatic Rollover Other Alternatives

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- Alternative to automatic rollovers will be to retain benefits in plan or reduce minimum cashout level to \$1,000.
  - Must track addresses of terminated employees and beneficiaries
    - DB plans continue to pay PBGC premiums for small unpaid benefits
  - Plan amendments to eliminate automatic distributions and rollovers must be made by same post- March 28, 2005 deadline ((December 31, 2005 for calendar year plans)
  - Plans may wish to allow elective distributions of under \$5,000
    - DB plans may allow elective benefits of under \$5,000 subject only to participant consent, i.e., w/o spousal consent
    - Informal IRS guidance indicates DB plans need not offer immediate annuity choices for elective benefits of under \$5,000
- Employers may wish to eliminate automatic distributions and rollovers and to review offering automatic rollovers once the IRA rollover market is more fully developed



# Options

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## **Adopt Automatic Rollover rules**

- Choose a partner! (DC plan vendor or IRA provider)  
Exercise good governance (see DOL guidance for tips)
- Changes to communications in advance of March 28, 2005, even if delayed operational date (revised 402(f) notice or other)
- Changes to plan administrative forms (“cashout” package)
- Plan amendments (may be delayed until end of first PY ending on/after March 28, 2005)
- SPD changes



# Options (continued)

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## **Eliminate involuntary cashouts of amounts greater than \$1,000**

- May retain “elective” cashout up to \$5,000 – does the plan already allow elective cashouts over \$5,000?
- New communication requirements in advance of March 28, 2005 (revised 402(f) notice or other communications)
- Changes to plan administrative forms may be necessary
- Plan amendments (may be delayed until end of first PY ending on/after March 28, 2005)
- SPD changes



# Automatic Rollover

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	<b>Pros</b>	<b>Cons</b>	<b>Steps</b>
<b>Automatic Rollovers</b>	<ul style="list-style-type: none"> <li>• Eliminates payout duties</li> <li>• DB: reduces PBGC fees</li> <li>• DC: may improve vendor fees, more asset to vendors</li> </ul>	<ul style="list-style-type: none"> <li>• Requires vendor selection and fee comparison</li> <li>• DB: may be more difficult to implement</li> <li>• Possible safe harbor compliance issues</li> <li>• Changes to 402(f) notice likely needed very soon</li> </ul>	<ul style="list-style-type: none"> <li>• Amend 402(f) Notice, await additional guidance</li> <li>• Implement new procedures by 12/1/05</li> <li>• Amend plan by last day of PY ending <math>\geq</math> 3/28/05</li> </ul>
<b>Lower Threshold</b>	<ul style="list-style-type: none"> <li>• Avoids vendor selection and fee comparison</li> <li>• DB: may be easier to implement</li> </ul>	<ul style="list-style-type: none"> <li>• Continues payout duties</li> <li>• DB: maintains PBGC fees</li> <li>• DC: may increase vendor fees</li> <li>• Changes to other forms likely needed very soon</li> </ul>	<ul style="list-style-type: none"> <li>• Decide on whether to offer optional distributions</li> <li>• Amend 402(f) Notice</li> <li>• Implement new procedures by 3/28/05</li> <li>• Amend plan by last day of PY ending <math>\geq</math> 3/28/05</li> </ul>



# Some Considerations

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- Cost of adopting new rule versus the alternative:
  - Cost and administrative time in adopting the rule (discuss with vendors being considered)
  - Alternatively, the cost of keeping participants around
  - Burden of changing 402(f) notice vs. other forms
- Consider likely plan experience:
  - Given plan design and history, employer records, etc.
- Policy issues:
  - How important is uniformity between DB and DC plans?



# What Can Vendors Do for Me?

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- Talk to your 401(k) provider
- Limited number of other providers that can help
- Market is continuing to develop
- Delaying your operational practice until later in the year could provide more choices
  - Possibility of automatic rollover, but not all safe harbor details, must be disclosed to participants in the near future so their affirmative elections will be valid.



# A Look at the Market for Rollovers

- Market for default (automatic rollover) IRAs is still developing
  - Some bundled retirement plan providers will support non-record kept plans, and others will not
    - More implementation issues for DB plans than for DC plans
  - Most unbundled retirement plan providers seeking alliances with IRA vendors
  - Variety of information requirements and service offerings



# A look at the vendors

Vendor	Plans	Amounts	Info Required	Safe Harbor	Status	Bundled SPD+	Other SPD+	Proto-type Amends
401(k) Company	C,E	A,B	N, AN, S	Y	S	A	A	N/A - We do not offer prototype amendments, however, all of our clients will have their respective amendments completed by 03/28/05
Amex					I	Y	Y	Y
AMVESCAP					I			
Charles Schwab	A,D	A	N,AN,S,D	Y	S			
CitiStreet	G	B	N,A,S,D,E	Y	S			
Diversified					I			
Fidelity	A*	A	TBD	Y	S, I	TBD	TBD	TBD
Hewitt	A, D	A	TBD	Y	S	N/A	C,F	N/A
JP Morgan	A	A	N, AN, S, D	Y	S	B 7/1/2005	TBD *	A**



# A look at the vendors

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Vendor	Plans	Amounts	Info Required	Safe Harbor	Status	Bundled SPD+	Other SPD+	Proto-type Amends
Lincoln	A,D	C, E in the future	N,A,S,D,C,E	Y	S	A & B*	A & B**	A
Mass Mutual					I			
Mellon					I			
Merrill Lynch	G	C	N, A, S	Y	S			
Millennium Trust Co.								
Milliman	A, D	A, E	N, A, SSN	Y	S			
Principal	A, D	A	N, AN, S, D, E	Y,N	I			



# A look at the vendors

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Vendor	Plans	Amounts	Info Required	Safe Harbor	Status	Bundled SPD+	Other SPD+	Proto-type Amends
Prudential	A,B,D,E	A,G	N,A,S,D,L, E	Y	S	E,F	E,F	A
Putnam	B, E	C, G	TBD	Y	S			
Rollover Systems								
T. Rowe Price	A, E	A, F, G, E	N, A, S, D, L	Y	S	A	A	TBD
Vanguard	A	A	N, AN, E, S, D, C	Y	S, I			
Wachovia	G	A	N,AN,L	Y	S	E,F	E,F	A
Wells Fargo	A	A	AN, S, D, C	Y	I	C		Y



# A look at the vendors

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**Plans:** (A) Record kept dc only; (B) Non-record kept dc only if another record keeping relationship; (C) All dc;  
(D) Record kept db only; (E) Non-Record kept db only if another record keeping relationship; (F) All db;  
(G) All db and dc; (H) Other (specify)

**Amounts:** (A) Above \$1,000; (B) Not supporting record keeping of prior rollovers, so in practice limited to \$5,000 cap; (C) Any amount;  
(D) Only initial contributions; (E) Allows future rollovers; (F) Allows future annual contributions; (G) Allows any future contributions

**Info Required:** N = Name; AN = Address (no PO Box); A = Address (PO Box okay); S = SSN; D = Date of birth; C= Citizenship  
O = Other (specify); L = Last known; E = Cannot be known to be outdated (e.g. cannot use Address of returned mail)

**Safe Harbor:** Y = Safe Harbor; N = Non-Safe Harbor

**Status:** S = Strategy still under development; I = Response to specific inquiry pending

**Bundled SPD+:** (A) Will distribute updated SPD or SMM and updated 402(f) Notice by 2/26/05; (B) Will distribute updated SPD or SMM and updated 402(f) Notice after 2/28/05 (and if so, specify date); (C) Will distribute updated SPD or SMM only by 2/26/05;  
(D) Will distribute updated 402(f) Notice only by 2/26/05; (E) Will distribute updated SPD or SMM after 2/26/05; (F) Will distribute updated 402(f) Notice only when IRS updates Model. For plans that eliminate mandatory cash outs/automatic rollovers, provide italicized codes if any of the answers are different.

**Other SPD+:** (A) Will distribute updated SPD or SMM and updated 402(f) Notice by 2/26/05; (B) Will distribute updated SPD or SMM and updated 402(f) Notice after 2/28/05 (and if so, specify date); (C) Will distribute updated SPD or SMM only by 2/26/05;  
(D) Will distribute updated 402(f) Notice only by 2/26/05; (E) Will distribute updated SPD or SMM after 2/26/05; (F) Will distribute updated 402(f) Notice only when IRS updates Model. For plans that eliminate mandatory cash outs/automatic rollovers, provide italicized codes if any of the answers are different.

**Proto Amends:** Y = Will provide draft prototype amendment for plans wishing to eliminate mandatory cash outs/automatic rollovers before March 28, 2005; A = Will provide, but only if IRS provides model amendment; N = Will not provide draft prototype amendment



# What Are Companies Doing?

Some statistics -

- Clients eliminating the automatic cashout: **Very small percentage**
- Clients eliminating automatic cash-out above \$1,000: **More than 50% of DC Plans**
- Clients selecting the safe harbor option: **Less than 50% of DC Plans**
- Clients keeping the cashout above \$5,000: **Not many DC Plans.**



# Need More Information?

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If you have any questions or need additional assistance please contact:

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