



Retirement Plan Sponsors Must Decide Soon Whether to Implement New Automatic Rollover Requirements

February 22, 2005

On February 16, 2005, the IRS released an *Employee Plans News* news flash, clarifying that the deadline for amending retirement plans to reduce or eliminate the \$5,000 limit for involuntary distributions is the end of the first plan year ending on or after March 28, 2005. Such an amendment would be made to avoid the automatic individual retirement arrangement (IRA) rollover provisions added by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which become effective on March 28, 2005. These provisions will require plans that cash out benefits of \$5,000 or less without participant consent to establish IRAs on behalf of participants who do not make affirmative payment or rollover elections. As discussed in greater detail below, plan sponsors now need to decide whether to amend their plans to comply with the automatic rollover requirements or to eliminate the involuntary distribution of benefits of more than \$1000. The following provides a summary of what plan sponsors should consider when making this decision.

Overview

Under current law, when a participant terminates employment, a plan may immediately distribute the participant's benefit in a lump sum without the participant's consent if the present value of the benefit is \$5,000 or less (an "involuntary distribution"). Generally, the participant may elect to receive the distribution in cash or have it paid as a direct rollover into an eligible retirement plan (such as another employer's retirement plan or an IRA). Before making the distribution, the plan administrator must provide the participant with a written explanation of these payment options and the related tax consequences. This written explanation is known as the "Section 402(f) Notice" or the "Special Tax Notice."

EGTRRA requires that involuntary distributions of more than \$1,000 must be rolled over into a designated IRA, absent an affirmative election by the participant to have the distribution paid in cash or as a direct rollover. Plan administrators must provide advance written notice, as part of the Special Tax Notice or as a separate notice, that unless the participant elects otherwise, his or her distribution will be transferred into an IRA. The written notice must identify the trustee or issuer of the IRA.

Distributions Subject to Automatic Rollover Requirements

In Notice 2005-5, the IRS clarified that the automatic rollover requirements apply to any involuntary distribution of more than \$1,000 made before a participant reaches normal retirement age under the plan (or age 62, if later). Amounts attributable to rollover contributions into the plan *are* taken into account when determining if a participant's benefit exceeds \$1,000 (even though these amounts need not be taken into account when determining if the value of the participant's benefit is \$5,000 or less and, thus, payable without the participant's consent). Distributions to surviving spouses and alternate payees are not subject to the automatic rollover requirements.

DOL Safe Harbor for Plan Fiduciaries

Department of Labor (DOL) regulations provide a "safe harbor" for satisfying the fiduciary responsibilities associated with (1) selecting an institution to receive the automatic rollover and (2) making an initial investment election for the rollover funds. Generally, the safe harbor requires that the plan fiduciary enter into a contract with the IRA provider on behalf of the participant. The IRA must be invested in a product that is designed to preserve principal and provide a reasonable rate of return, and the fees and expenses associated with the IRA may not exceed those the provider charges for comparable IRAs (other than those established for automatic rollovers). The DOL safe harbor applies to all automatic rollovers, including those of less than \$1,000 and those in excess of \$5,000 (because they include prior rollovers that are not taken into account).

The plan administrator must also provide participants with an updated summary plan description (SPD) or a summary of material modifications (SMM) that describes the automatic rollover requirements, the investment product, fees (and whether any will be borne by the plan or the plan sponsor), and, if not otherwise provided in the updated SPD or in the applicable SMM, the name, address and phone number of a plan contact for more information about the plan's automatic rollover provisions, the IRA provider, and the fees and expenses associated with the IRA.

Plan Sponsors Must Decide How to Proceed

Plan sponsors need to decide whether to amend their plans to comply with the automatic rollover requirements or to eliminate the involuntary distribution of benefits that are more than \$1,000.

To Provide Automatic Rollovers. The following steps must be taken with respect to plans that will continue to make involuntary distributions in excess of \$1,000 and, thus, must comply with the automatic rollover requirements:

- ***Amend Plan.*** Plans must be amended to provide for automatic rollovers, and the IRS provides a sample amendment in Notice 2005-5. The deadline for amending calendar-year plans is December 31, 2005; however, non-calendar-year plans must be amended by the last day of the first plan year ending on or after March 28, 2005. **FOR NON-CALENDAR-YEAR PLANS, AMENDMENTS MAY BE REQUIRED AS EARLY AS MARCH 28, 2005.**
- ***Update Distribution Notice.*** Plan administrators must revise the Special Tax Notice or create a separate notice that explains the automatic rollover requirements.

- **Update SPD.** Plan administrators need to provide an updated SPD or an SMM describing the automatic rollover provisions.
- **Contract with Individual Retirement Plan Providers.** Plan administrators must select and make arrangements (with the DOL fiduciary safe harbor in mind) with financial institutions to accept automatic rollovers. So far, it appears that many financial institutions and service providers will accept automatic rollovers only from plans for which the institutions or providers already hold assets.

The IRS provides transition relief that gives plans until December 31, 2005 to put automatic rollover procedures in place.

To Avoid Automatic Rollovers. Plan sponsors can avoid the automatic rollover requirements by amending their plans, to the extent necessary, to eliminate involuntary distributions of more than \$1,000. Plans may continue to require a lump-sum form of payment (without spousal consent) for all benefits of \$5,000 or less (determined without taking rollovers into account, if the plan so provides). However, plans may not simply force immediate payment of those benefits if they are more than \$1,000. The following steps will need to be taken to eliminate involuntary distributions from plans:

- **Amend Plan.** Plan sponsors must review their plan documents to determine whether any amendments are necessary (e.g., removing provisions that require the immediate payment of benefits that are between \$1,000 and \$5,000). Any necessary amendments need to be adopted by the last day of the plan year ending on or after March 28, 2005.
- **Update Distribution Notices.** Distribution notices may need to be revised to indicate that participant consent is now required for lump-sum payments between \$1,000 and \$5,000. Sponsors of defined benefit plans may want to create a separate notice for this group of participants that does not include the complicated benefit comparisons that must be provided to participants who are eligible for annuities.
- **Update SPD.** Plan administrators will need to review their SPDs to determine whether any updates are necessary. An updated SPD (or an SMM) may be necessary, for example, to reflect that participants may defer payment of benefits that are between \$1,000 and \$5,000.

Plan sponsors should keep in mind that reducing the limit on involuntary distributions from \$5,000 to \$1,000 may increase the cost of maintaining plans if enough participants leave their benefits in their plans, and may create additional responsibilities for plan fiduciaries (e.g., locating participants and accounting for small benefits). Sponsors of defined benefit plans will also be required to pay PBGC premiums on behalf of participants who defer payment.

If you have questions or would like further information about EGTRRA's automatic rollover requirements, please contact the attorney with whom you regularly work or any of the following:

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