Butzel Long

A PROFESSIONAL CORPORATION

ATTORNEYS AND COUNSELORS

ANTOINETTE M. PILZNER

DIRECT DIAL (734) 213-3630
INTERNET pilzner@butzel.com

ANN ARBOR OFFICE
SUITE 300 350 SOUTH MAIN STREET
ANN ARBOR, MICHIGAN 48104-2131
(734) 995-3110 fax (734) 995-1777

March 30, 2004

BY ELECTRONIC MAIL AND FEDERAL EXPRESS OVERNIGHT

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Attention: Automatic Rollover Regulation

Dear Sir or Madam:

On behalf of the Society for Human Resource Management, we are submitting comments to the Department of Labor, Employee Benefits Security Administration ("EBSA"), on the proposed regulation establishing an Automatic Rollover Safe Harbor for purposes of fiduciary responsibility under the Employee Retirement Income Security Act of 1974 ("ERISA") which was published on March 2, 2004 in the *Federal Register* at 69 Fed. Reg. 9900.

STATEMENT OF INTEREST

The Society for Human Resource Management (the "Society" or "SHRM") is the world's largest association devoted to human resource management. Representing more than 180,000 individual members, the Society's mission is to serve the needs of human resource ("HR") professionals by providing the most essential and comprehensive resources available. As an influential voice, the Society's mission is also to advance the human resource profession to ensure that HR is recognized as an essential partner in developing and executing organizational strategy. Founded in 1948, SHRM currently has more than 500 affiliated chapters within the United States and members in more than 120 countries.

SHRM's membership is comprised of HR professionals who balance strategic, operational, and administrative roles. Additionally, many HR professionals play an extensive role in the administration of employee benefit plans. SHRM has a strategic interest in the final safe harbor regulation the Department of Labor will promulgate to govern automatic rollover distributions from tax-qualified employee pension benefit plans. These comments reflect the substantial expertise and experiences of the Society's members.

INTRODUCTION

SHRM welcomes this opportunity to comment on the proposed Automatic Rollover Safe Harbor regulation. Many SHRM members will be charged with implementing and administering the automatic rollover requirements; however, SHRM members with administrative responsibilities for tax-qualified pension benefit plans subject to ERISA also have fiduciary obligations to plan participants. SHRM's comments on the proposed regulation therefore seek to balance these fiduciary obligations with administrative efficiency and effectiveness.

AUTOMATIC ROLLOVER SAFE HARBOR

SHRM's comments on proposed Automatic Rollover Safe Harbor regulation follow the order of the proposed regulation and the accompanying Overview.

1. Scope (Proposed 29 CFR § 2550.404a-2(a))

SHRM acknowledges that the specific statutory charge to the Department of Labor was to establish a regulatory safe harbor for mandatory distributions of more than $1,000, and understands that the final Automatic Rollover Safe Harbor regulation will not be extended to mandatory distributions of $1,000 or less. However, as practical matter, plan administrators will be looking to the final Automatic Rollover Safe Harbor regulation for guidance in complying with their fiduciary responsibilities when making mandatory distributions of $1,000 or less, as well as when making distributions exceeding $5,000 that are required as a result of a plan termination.

SHRM encourages the EBSA to publish an advisory opinion, information letter, or other formal guidance authorizing plan administrators to apply the provisions of the final Automatic Rollover Safe Harbor regulation to mandatory distributions of $1,000 or less and to distributions exceeding $5,000 that are required as a result of a plan termination. SHRM believes this will:

A. Provide a uniform standard for automatic rollovers of all mandatory distributions from tax-qualified retirement benefit plans, which directly benefits the former plan participants entitled to mandatory distributions;

B. Provide plan administrators of terminating defined contribution plans a method for distributing benefits to missing participants that parallels the ability of plan administrators of terminating defined benefit plans to transfer to the Pension Benefit Guaranty Corporation nonforfeitable accrued benefits payable to missing participants so that the distribution of plan benefits, and correspondingly the plan termination, can be completed; and

C. Enable the plan administrators of plans required to make these other types of mandatory distributions, and particularly mandatory distributions from terminating plans, to provide for the effective and efficient administration of both the plans and the distributions.

2. Safe Harbor (Proposed 29 CFR § 2550.404a-2(b))

SHRM notes that the proposed regulation does not specifically state that a mandatory distribution to an automatic rollover IRA under the safe harbor satisfies ERISA Section 404(c)(3). As you know, ERISA Section 404(c)(1) provides that a plan fiduciary is not liable for investment losses resulting from a plan participant or beneficiary exercising investment control over an individual plan account when specific conditions are satisfied. However, ERISA Section 404(c)(3) provides that a plan participant or beneficiary is not treated as exercising investment control over an automatic rollover IRA:

A. Unless the transfer to the automatic rollover IRA is made in a manner consistent with guidance provided by the Secretary of Labor; or

B. Until the earlier of:

1. A rollover of any portion of the mandatory distribution to another IRA; or
2. One year after the mandatory distribution is made.

SHRM presumes that a mandatory distribution to an automatic rollover IRA under the safe harbor satisfies A, above, so that plan fiduciaries will not be liable for investment losses incurred by the automatic rollover IRA. If this presumption is correct, SHRM recommends that Subsection 2550.404a-2(b) of the proposed regulation be revised to clearly state that if a fiduciary meets the conditions of paragraph (c) of the regulation, the participant or beneficiary for whom the automatic rollover IRA is established will be treated as exercising control over the assets of the automatic rollover IRA as of the date of the transfer under Section 404(c)(3) of ERISA.

3. Conditions – Amount of Distribution (Proposed 29 CFR § 2550.404a-2(c)(1))

As noted above, SHRM understands the statutory constraint on the range of the amount of the distributions to which the Automatic Rollover Safe Harbor regulation can apply. SHRM does, however, appreciate the specific recognition in the Overview that the amount of a distribution is determined with reference to the plan's election to include or exclude prior

rollover contributions in computing the present value of the nonforfeitable accrued benefit to be distributed.

SHRM strongly encourages the EBSA to restate this observation in the Preamble to the final Automatic Rollover Safe Harbor regulation.

4. Conditions – Individual Retirement Plan (Proposed 29 CFR § 2550.404a-2(c)(2))

SHRM concurs with the EBSA's conclusion, incorporated into the proposed regulation, that existing standards under the Internal Revenue Code of 1986, as amended (the "Code") and associated Treasury Regulations sufficiently protect plan participants and beneficiaries who become individual retirement account ("IRA") holders as a result of an automatic rollover. The existing requirements under the Code and the Treasury Regulations are accepted as providing sufficient protection for current IRA owners. A former participant in a tax-qualified plan whose benefits are automatically rolled over under the plan's mandatory distribution rule does not need a more "qualified" IRA than a former participant who affirmatively elects to have his or her mandatory distribution directly rolled over to an IRA. The essential function and purpose of the IRA receiving the automatic rollover is the same as an IRA receiving an elective rollover, which supports applying the same criteria to IRA custodians, trustees, and issuers in both situations.

SHRM recommends that this Paragraph of the proposed regulation be adopted as final without revisions.

5. Conditions – Permissible Investments (Proposed 29 CFR § 2550.404a-2(c)(3))

SHRM agrees with the proposed regulation that a safe harbor investment for an automatic rollover IRA should include an investment product offered by a state or federally regulated financial institution and designed to preserve principal, provide liquidity and a reasonable rate of return, and maintain a stable dollar value. These investment criteria address two important components of an automatic rollover IRA. The liquidity requirement permits the individual for whom the automatic rollover IRA is established to select new investments without risk of liquidity loss. The preservation of principal requirement protects the automatic rollover IRA against investment losses, even though it may not always protect against inflation losses.

No Ongoing Obligation to Monitor

SHRM believes the proposed regulation should clearly state that the determination of whether an investment product satisfies the safe harbor requirements is based only on information the plan fiduciary knew or should have know as of the date the mandatory distribution is transferred to the automatic rollover IRA. As discussed in item 2, above, SHRM

presumes that the participant or beneficiary for whom the automatic rollover IRA is established will be treated as exercising control over the assets in the automatic rollover IRA as of the date of the transfer, under ERISA Section 404(c)(3). Accordingly, the plan fiduciary will not have an ongoing obligation to monitor the investment products selected for the automatic rollover IRA to ensure that the investment products continue to satisfy the safe harbor after the transfer date. The final regulation should clearly indicate this limitation on the plan fiduciary's responsibility.

SHRM strongly recommends that Subparagraph 2550.404a-2(c)(3)(i) of the proposed regulation be revised to clearly state that the determination of whether an investment product is designed to protect principal and provide a reasonable rate of return, consistent with liquidity and taking into account paragraph (c)(4) is to be made based on information the fiduciary knew or should have known on the date the investment product was selected, and that the investment product must only satisfy the safe harbor requirements at the time the automatic rollover IRA is established and the investment product is selected.

Additional Permissible Investments

SHRM disagrees with provision in the proposed regulation that safe harbor investments do not automatically include investments identical to those into which the participant or beneficiary had affirmatively directed his or her individual plan account. This provision "interrupts" an otherwise continuous exercise of investment control by the participant or beneficiary under ERISA Section 404(c).

Presuming that the circumstances under which the participant or beneficiary last exercised investment control satisfied ERISA Section 404(c)(1), the plan fiduciaries were not liable for investment losses resulting from that exercise of investment control. Presuming that the mandatory distribution to an automatic rollover IRA satisfies the safe harbor, the participant or beneficiary for whom the automatic rollover IRA is established is treated as exercising investment control under ERISA Section 404(c)(3), so the plan fiduciaries will be protected from liability for investment losses incurred by the automatic rollover IRA. But the proposed regulation provides that the participant or beneficiary is not treated as exercising investment control for the instant in which the transfer to the automatic rollover IRA occurs, exposing the plan fiduciaries to liability for investment losses because the fiduciaries are required to substitute their investment choices for the investment choices previously made by the participant or beneficiary.

This deemed interruption in the participant's or beneficiary's exercise of investment control does not appear to be supported by the EBSA's position, as stated in the Overview, that an investment strategy adopted by a participant while participating in a defined contribution plan would not necessarily continue to be appropriate for the participant in the context of an

automatic rollover IRA. The same argument could be applied to a former participant who is not subject to the mandatory distribution rules because his or her accrued nonforfeitable benefit has a present value of only $1 greater than the maximum amount under Code Section 401(a)(31)(B). The last investment strategy adopted by the former participant may no longer be appropriate for that former participant. However, under ERISA Section 404(c)(1), the plan fiduciaries are not liable for any investment losses resulting from that investment strategy as long as the individual plan account is not mandatorily distributed.

The participant who is subject to the mandatory distribution rules and the participant who is not subject to the mandatory distribution rules have each exercised investment control over their individual plan accounts. The proposed regulation obligates the plan fiduciary to disregard the investment control exercised by the participant who is subject to the mandatory distribution rules, exposing the plan fiduciary to potential claims for breach of fiduciary duty in selecting the investment products in the automatic rollover IRA. SHRM does not believe that a plan fiduciary should be required to substitute a participant's exercise of investment control with the plan fiduciary's investment choices solely because the participant is subject to the mandatory distribution rule.

SHRM recommends that Subparagraph 2550.404a-2(c)(3)(i) of the proposed regulation be revised to provide that, if the participant or beneficiary affirmatively exercised control over the assets in his or her individual plan account at any time prior to the date of the mandatory distribution, the mandatory distribution may be invested in investment products that are identical to the investment products in which the participant or beneficiary's individual plan account was invested immediately prior to the transfer.

6. Conditions – Permissible Fees and Expenses (Proposed 29 CFR § 2550.404a-2(c)(4))

SHRM supports the proposed regulation's requirement that all fees and expenses related to the establishment and maintenance of an automatic rollover IRA are chargeable only against the IRA and are not required to be borne by the distributing plan or plan sponsor. Similarly, SHRM supports the requirement that fees and expenses charged by an IRA provider against an automatic rollover IRA cannot exceed fees and expenses charged by the IRA provider against comparable IRAs established with voluntary rollovers ("voluntary rollover IRA").

However, SHRM does not support the proposed regulation's requirement that fees and expenses of the automatic rollover IRA other than establishment charges ("maintenance fees and expenses") can only be charged against investment income earned by the automatic rollover IRA, for two reasons. First, limiting maintenance fees and expenses to the automatic rollover IRA's investment income would put an automatic rollover IRA in a better position than a voluntary rollover IRA. SHRM believes an automatic rollover IRA should be protected against

invasion of principal for maintenance fees and expenses only if the IRA provider promises the same protection to a voluntary rollover IRA.

Second, SHRM believes that limiting the amount of permissible maintenance fees and expenses will discourage IRA providers from designing and offering IRA products that satisfy the safe harbor. The permissible investments under the proposed safe harbor are limited to investments that traditionally offer lower rates of return in exchange for protection of principal and high liquidity. These lower rates of return can artificially limit the maintenance fees and expenses that IRA providers can charge to automatic rollover IRAs. As a result, SHRM is concerned that many IRA providers may decide to not offer IRA products that satisfy the safe harbor, which will limit the IRA products available for selection by plan fiduciaries. SHRM believes that the safe harbor should provide incentives, not disincentives, for IRA providers to offer IRA products that satisfy the safe harbor.

SHRM recommends that Subparagraph 2550.404a-2(c)(4)(ii) of the proposed regulation be deleted, leaving the general restriction in Subparagraph 2550.404a-2(c)(4)(i) as the sole restriction imposed on fees and expenses charged against an automatic rollover IRA.

7. Conditions – Required Disclosures (Proposed 29 CFR § 2550.404a-2(c)(5))

SHRM applauds EBSA's restraint in limiting the disclosure requirements in the proposed Automatic Rollover Safe Harbor regulation to providing information in the plan's summary plan description ("SPD"), or a summary of material modifications ("SMM") when appropriate. SHRM specifically supports the proposed regulation's requirement that the SPD or SMM only provide plan contact information, rather than specific information about the identity of the IRA provider or the specific fees and expenses associated with an IRA established to receive an automatic rollover from the plan. It is reasonable to expect that the identity of the IRA provider selected by the responsible plan fiduciary, and the amount of any fees and expenses associated with automatic rollover IRAs, will change from time to time. By only requiring that the SPD or SMM include plan contact information, plan administrators will not be required to distribute updated documents to all plan participants simply because that information changes. This provision also ensures that a plan participant will not erroneously refer to or rely on outdated information in an SPD or SMM about the identity of the IRA provider or about IRA fees and expenses.

SHRM recommends that this Paragraph of the proposed regulation be adopted as final without revisions.

8. Conditions - Prohibited Transactions (Proposed 29 CFR § 2550.404a-2(c)(6))

SHRM concurs with proposed regulation's general requirement that a plan fiduciary's selection of an IRA provider or IRA investments must not result in a prohibited transaction under ERISA unless a prohibited transaction exemption specifically applies. ERISA's existing prohibited transaction provisions and available exemption relief provide adequate protection for all plan participants, including former participants whose benefits are automatically rolled over under a plan's mandatory distribution rule in a manner that otherwise satisfies the regulatory safe harbor.

SHRM recommends that this Paragraph of the proposed regulation be adopted as final without revisions.

9. Miscellaneous Issues – Legal Impediments

SHRM is not sufficiently familiar with the customer identification and verification requirements of Section 326 of the USA PATRIOT Act to determine if the guidance issued in January 2004 by staff of the Department of Treasury and other Federal functional regulators addresses the concerns of banks and other financial institutions related to establishing automatic rollover IRAs without the direct participation of the participant or beneficiary for whom the automatic rollover IRA is being established. However, SHRM continues to be concerned that difficulties encountered by IRA providers in establishing automatic rollover IRAs because of federal and state signature and identification requirements will restrict the range of IRA products available for selection by plan fiduciaries.

10. Effective Date

SHRM believes that making the final Automatic Rollover Safe Harbor regulation effective only 6 months after the date the final regulation is published in the Federal Register will not give plan administrators and plan fiduciaries adequate time to comply with the final regulation. In order for a plan to be in compliance with the final regulation, all of the following must occur:

A. Banks, insurance companies, financial institutions, and other IRA providers must:

1. Review the final regulation, guidance on the customer identification and verification requirements of Section 326 of the USA PATRIOT ACT, and guidance from the Department of Treasury on the application of existing Code requirements to automatic rollovers;

2. Develop IRA products that comply with the final regulation, the identification and verification requirements, and the Treasury guidance; and
3. Publicize those products.

B. A responsible plan fiduciary must:

1. Assemble information about IRA providers and their compliant IRA products;
2. Engage in a prudent process to select an IRA provider and a compliant IRA product; and
3. Engage in a prudent process to select the investments for automatic rollovers to be transferred to the selected IRA providers and IRA products.

C. The plan administrator must:

1. Ensure that the plan is amended, as necessary;
2. Draft and distribute an SMM or an updated SPD; and
3. Ensure that the plan contact identified in the SMM or SPD has appropriate information about the selected IRA provider and the fees and expenses associated with the selected IRA product in order to answer questions resulting from the SMM or SPD.

SHRM presumes that the safe harbor protection of the regulation implicitly requires a plan fiduciary to prudently select an IRA provider, an IRA product, and investments that satisfy the safe harbor. The initial implementation period must provide plan fiduciaries adequate time to accomplish the tasks in B, above, in a prudent manner, in light of the fact that plan fiduciaries cannot even begin these tasks until the IRA providers complete the tasks in A, above. Similarly, a plan administrator cannot properly prepare the plan contact identified in the SMM or SPD to answer questions until the plan fiduciary has completed the tasks in B, above.

SHRM believes that an initial implementation period of 6 months will not give plan fiduciaries or plan administrators adequate time to accomplish all of the tasks necessary to comply with the final regulation on its effective date.

SHRM strongly recommends that the final Automatic Rollover Safe Harbor regulation become effective not less than 12 months after the later of:

A. The date the final regulation is published in the Federal Register; or

B. The date Treasury guidance on the application of existing Code rules to automatic rollovers is issued.

CONCLUSION

SHRM appreciates the opportunity to submit its comments to EBSA on the proposed Automatic Rollover Safe Harbor regulation. The Society understands the primary purposes of the automatic rollover safe harbor are to preserve the tax-deferred status of mandatory distributions to plan participants from tax-qualified pension benefit plans and to protect former plan participants' retirement assets after the assets are mandatorily distributed to IRAs. Equally, if not more, important to SHRM members is the safe harbor's guidance to plan fiduciaries and plan administrators in satisfying their fiduciary responsibilities under ERISA. SHRM believes that the final Automatic Rollover Safe Harbor regulation can successfully accommodate the needs of plan participants, plan administrators, and IRA providers, and looks forward to the promulgation of final regulation as soon as possible.

If you have any questions or require any further clarification of these comments, please let me know.

Very truly yours,

BUTZEL LONG

Antoinette M. Pilzner

Antoinette M. Pilzner

AMP
c: Wendy E. Wunsh, Esq., Society for Human Resource Management
108986