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COMMENTS ON PROPOSED RULE ON FIDUCIARY RESPONSIBILITY UNDER THE EMPLOYEE RETIREMENT SECURITY ACT OF 1974 AUTOMATIC ROLLOVER SAFE HARBOR

April 1, 2004

Office of Regulations and Interpretations
Employee Benefits Security Administration
United States Department of Labor
(submitted electronically)

The Profit Sharing/401(k) Council of America (PSCA) is a non-profit national association of employers who sponsor defined contribution retirement plans for their workers. For over fifty-five years, PSCA has identified and shared best practices with its members, represented their interests in Washington, and provided analysis and reportage on the latest regulatory changes. PSCA members range in size from very small independent businesses to firms with hundreds of thousands of employees. Our members believe that profit sharing, 401(k), and related savings and incentive programs strengthen the free-enterprise system, empower and motivate the workforce, improve domestic and international competitiveness, and provide a vital source of retirement income.

PSCA commends the Department for its proposed safe harbor rules for automatic rollovers of mandatory distributions. PSCA recognizes the importance of establishing measures to promote the retention of retirement assets when workers change employers. While the proposed rule provides simple and clear guidelines for plan sponsors, the limits on the ability to assess reasonable fees raise concerns that cost shifting to employers who voluntarily offer retirement plans to their workers could have a chilling effect on the expansion of retirement plans in the small business environment.

According to PSCA's "46th Annual Survey of Profit Sharing and 401(k) Plans," between ten and twenty percent, depending on plan size, of accounts in defined contribution plans are attributable to vested terminated former employees. While plan sponsors are becoming more willing to be responsible for the assets of retired workers, there is still resistance to assuming financial costs and fiduciary liabilities for the assets of former employees who may now be working for their competitors. Unless there is a viable automatic rollover system, employers will soon be forced to retain assets of their terminated vested employees between $1,000 and $5,000. This will become a hardship for employers, especially small companies whose plans have limited assets from which to draw the fees necessary to support these small accounts. In fact, it is likely that within a relatively short period that smaller companies, which typically have higher turnover rates than large companies, will end up with more terminated vested accounts with very small balances than accounts for active workers. It will be only a matter of time before the plan collapses under the weight of the fees required to maintain these balances. The proposed rule will also likely have a dampening effect on the growing trend to lower the period before which employees are not eligible to participate in a retirement plan.

Our specific comments follow:

Deemed satisfaction of fiduciary duties – The proposed rule provides that a fiduciary will be deemed to satisfy the duties under section 404(a) with respect to both the selection of the individual retirement account provider and the investment of funds in connection with the automatic rollover to the individual retirement account. After this regulation is final, ERISA section 404(c)(3) provides that a participant or beneficiary whose assets have been transferred as the result of I.R.C. section 401(a)(31)(B) will be treated as exercising control over the assets only after the earlier of the rollover of all or a portion of the assets to another individual retirement account or annuity or one year after the transfer is made. Additionally, subsection (3)(B) provides that a participant or beneficiary will be treated as exercising control over the assets upon a transfer that is made in a manner consistent with guidance provided by the Secretary. The final rule should clarify that a transfer made pursuant to the subject rule is a transfer described in section 404(c)(3)(B). Is this clarification consistent with the Department's interpretation of the provisions of the USA Patriot Act?

Section 404(c)(3) raises several issues. Subsection (A) provides that a participant or beneficiary shall be treated as exercising control over the assets of accounts subject to this proposed rule only upon the earlier of a rollover to another account or one year after the transfer is made. Who does the Department view as exercising control over these assets when these conditions are not met and subsection (B) is not applicable? Are the assets in these rollover accounts plan assets? Are the holders of these accounts plan participants or beneficiaries?

Investment product – Many of these accounts will be maintained with the automatic rollover provider for years. As a result, the safe harbor should not preclude the possibility that an automatic rollover provider may develop, and plan sponsors may want to choose, to manage automatic rollover in a diversified investment option. PSCA recommends that the final rule include balanced funds that invest in several asset classes as an acceptable investment choice.

Regulated financial institution – The definition of a regulated financial institution in section 2550.404a-2(c)(3)(ii) should be amended to include trustees as defined in 26 CFR 1.408-2(b)(2)(i). This definition includes independent trust companies and other nonbank trustees who satisfy certain requirements. Footnote ten in the overview of the proposal references 26 CFR 1.408-2(b)(2)(i) to illustrate institutions that would provide individual retirement plans, but the definition in the proposed rule is less inclusive.

Fees and expenses – The restrictions on the ability to recover reasonable fees and expenses for these individual retirement accounts is a grave concern and sets an ominous precedent in which the long established ability to charge market based fees within the ERISA framework is reversed. These restrictions are contrary to, and more oppressive than, the rules that permit fiduciaries to use plan assets to defray reasonable expenses of administering a plan. All fees and expenses cannot exceed the fees and expenses charged by the individual retirement plan provider for comparable accounts established for distribution rollovers that are not subject to the automatic rollover provisions. Simply put, this is an "apples-to-oranges" comparison. Individual retirement accounts instituted for automatic rollover distributions will have considerably smaller average balances than other rollover distribution accounts. Mandated equal expense schedules for all types of accounts will likely result in the inability to fully recover costs associated with automatic rollover accounts. Of equal concern is the much higher probability of terminations of the automatic rollover accounts, frequently almost immediately following the establishment of the account. Certainly, individuals who deliberately choose to invest in an individual retirement account are more likely to remain as an investor than individuals who finds themselves with an investment that is the result of inaction on their part. Terminations are costly events. The inability to fully recover these costs will have a chilling effect on the use of the automatic rollover provision and, as we noted previously, have a negative effect on voluntary employer plan sponsorship.

Additionally, all fees and expenses, except establishment costs, may be charged only against the income earned by the individual retirement account. Establishment costs will be limited by the comparability rules described in the preceding paragraph. One has to look no further than today's historically low interest rates to understand the real possibility that accounts instituted under this proposal will have to have their costs subsidized through some form of cost shifting. The cost shifting will impact either employers or other plan participants (through an indirect cost-shifting by providers) and will diminish the attractiveness of employer-provided retirement plans.

PSCA recommends that the final rule permit the assessment of reasonable fees for individual retirement accounts established in response to the automatic rollover requirements. The general principals governing the use of plan assets to defray reasonable expenses should be applicable to this process. Importantly, the low average balances and expected inordinately high termination rate should be explicitly recognized as factors to be considered when determining reasonable costs.

Disclosure – PSCA commends the Department for the provisions regarding notification to participants. The proposed rules are reasonable and balance administrative costs and notice rights of participants and beneficiaries.

Additional guidance – As the proposed rule discusses, the standards discussed in this proposed rule are not the exclusive means to satisfy the fiduciary requirements with respect to automatic rollovers of mandatory distributions. PSCA recommends that the Department provide additional guidance, as soon as possible, on suggested methodologies for determining reasonable costs for these accounts in a non-safe harbor environment. PSCA suggests that such methodologies would follow existing guidance on the use of plan assets to defray reasonable expenses. Such methodologies should explicitly recognize that higher costs associated with low average balances and high termination rates are a factor in determining reasonable expenses. The Department should also issue further guidance on transfers that are qualified transfers under I.R.C. section 404(c)(3)(B).