

Automatic Rollover Requirements for Qualified Plans, 403(b) Plans, Government 457(b) Plans and Church Plans Take Effect on March 28, 2005

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Many qualified retirement plans, 403(b) plans, government 457(b) plans and church plans provide for involuntary, mandatory distributions ("cashouts") of participant accounts that do not exceed \$5,000. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), cashouts between \$1,000 and \$5,000 that are distributed on or after March 28, 2005, must be automatically rolled over to an IRA if the participant does not elect to roll over the distribution or to receive the distribution directly.

The IRS and the Department of Labor have both issued guidance concerning the automatic rollover requirements. The key points of that guidance are summarized below.

IRS GUIDANCE

In Notice 2005-5, the IRS provided a series of questions and answers concerning the automatic rollover requirements. Highlights of Notice 2005-5 include the following:

- A plan may delay the payment of a post-March 27, 2005, cashout until it adopts sufficient administrative procedures for automatic rollovers, provided the cashouts are paid on or before December 31, 2005.
- A plan sponsor may eliminate mandatory cashouts from its plan without violating the anti-cutback rules of the Internal Revenue Code.
- If a plan disregards rollover contributions to a participant's account in determining whether the account exceeds \$5,000, the rollover contributions that exceed \$5,000 are also subject to the automatic rollover requirements of EGTRRA.
- Participants must be notified of the automatic rollover rules before their benefits may be automatically rolled over. However, this notice may be part of the direct rollover notice that plans are already required to provide with respect to eligible rollover distributions. A plan administrator will be deemed to have provided the notice even if it is returned as undeliverable by the United States Postal Service if the notice was mailed to the most recent address in the records of the employer and plan administrator.
- The automatic rollover rules apply to government 457(b) plans and church plans. In certain instances, however, the effective date of the new requirements may be delayed in order to give the appropriate legislative body or church convention time to implement the rules.
- Plans must be amended to reflect the automatic rollover requirements by the end of the first plan year ending on or after March 28, 2005. The IRS has provided a sample amendment for this purpose, which is at the end of this article.

In a news release issued earlier this month, the IRS indicated that plan sponsors may amend a plan retroactively to eliminate cashouts on or after March 28, 2005, so long as the amendment is made by the end of the first plan year ending on or after March 28, 2005.

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DOL GUIDANCE

In regulations issued last fall, the Department of Labor ("DOL") listed six conditions that a plan subject to ERISA must satisfy to be deemed in compliance with the automatic rollover rules. The six conditions are:

- The present value of the distribution may not exceed \$5,000. In determining the value of the distribution, amounts that the participant previously rolled over into the plan, and earnings on those amounts, do not need to be taken into account.
- The automatic rollover must be made to an individual retirement account or individual retirement annuity as described in Sections 408(a) or 408(b) of the Internal Revenue Code.
- Automatic rollovers must be invested in products that are designed to preserve principal while providing a reasonable rate of return. The investment product must also seek to provide a stable dollar value, and must be provided by a state or federally regulated financial institution such as a federally insured bank or credit union.
- The costs associated with automatic rollovers cannot exceed the costs charged by the provider for regular IRA rollovers.
- The participant must be given notice of the plan's automatic rollover provisions. This notice must meet certain specific content requirements, and may be provided in a summary plan description or summary of material modifications.
- Plan fiduciaries may not engage in prohibited transactions in carrying out the automatic rollover requirements. The DOL has issued a prohibited transaction class exemption that would allow a bank or other financial institution to select itself as the IRA provider for rollovers from its own plan, to select its own funds as investment products for rollovers from its own plan, and to receive associated fees.

Once a plan makes an automatic rollover that complies with these rules, the individual whose account is rolled over will no longer be considered a plan participant and the plan will no longer have fiduciary responsibilities with respect to the assets that have been rolled over. Employers may, but are not required to, apply the automatic rollover provisions to involuntary distributions of less than \$1,000.

ACTIONS THAT SHOULD BE TAKEN

As noted, plans sponsors have until the end of the first plan year ending on or after March 28, 2005, to implement the automatic rollover requirements or to amend their plans to eliminate cashouts (or to eliminate cashouts that exceed \$1,000). However, we recommend that plan sponsors decide which approach to take (*i.e.*, whether to keep cashouts and comply with the new rules, or to eliminate cashouts that would be subject to the new rules) prior to the March 28, 2005, effective date. Once this decision is made, appropriate plan amendments and revisions to participant notices, election forms and summary plan descriptions should be implemented.

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