GROOM
LAW GROUP
www.groom.com

MEMORANDUM TO CLIENTS

March 24, 2005

Re: DOL Proposed Abandoned Plans Program

The Department of Labor ("DOL") recently published for comment three proposed regulations and a proposed class exemption that address the problem of abandoned plan assets held by financial institutions. 70 Fed. Reg. 12046, 12074 (Mar. 10, 2005). The proposed regulations and exemption are designed to encourage service providers to voluntarily terminate abandoned plans and distribute their assets to participants by limiting their liability and allowing them to receive fees in connection with termination activities. We believe that the program generally provides significant protections for institutions that wish to terminate abandoned plans. Unfortunately, the program's usefulness is handicapped by the fact that a substantial number of entities holding plan assets will be ineligible to participate; and, because of fee restrictions, financial institutions may be unwilling to open IRA accounts in connection with abandoned plans. These issues are likely to be raised during the comment period which ends May 9.

DOL explained that it developed the program in response to requests for assistance from participants in so-called "abandoned plans." Plan abandonment often occurs because a plan sponsor has been dissolved in bankruptcy, incarcerated, or has disappeared, leaving no plan sponsor, named fiduciary or administrator in existence to administer the plan. Although a financial institution, such as a trustee, may hold the plan's assets, these institutions have no authority or incentive to perform the necessary steps to terminate the plan and distribute benefits to participants. As a result, participants are denied access to their benefits and plan assets are often unnecessarily diminished by recurring administrative costs. DOL has estimated that nearly $900 million in assets may belong to abandoned plans.

A. Overview of Program

In response to this problem, the DOL has developed a comprehensive program that permits, but does not require, certain financial institutions to terminate abandoned individual account plans. Under the proposed regulations, all activities related to the termination of abandoned plans must be performed by a "qualified termination administrator," or a "QTA." A termination administrator will be qualified only if it is eligible to be a trustee or issuer of an individual retirement account or annuity and it holds the assets of an abandoned plan. Under this definition, many service providers, such as recordkeepers, who hold abandoned plan assets will not qualify as QTAs and will not be eligible for the relief provided by DOL's program in its current form.

Under the regulations, a "QTA" may determine that a plan is abandoned when either no contributions to or distributions from the plan have been made in the last 12 months or other circumstances suggest that the plan is or may become abandoned. In addition, the QTA must determine that the plan sponsor no longer exists, cannot be located, or is unable to maintain the plan after making reasonable efforts to locate the plan sponsor. For purposes of abandonment determinations, a QTA will be deemed to have made reasonable efforts to locate the plan sponsor if it provides a notice informing the sponsor of its determination to the last known address of the sponsor, or a corporate sponsor's agent for service of legal process, by a method of delivery that acknowledges receipt. The proposal provides a model notice for use in notifying a plan sponsor of the QTA's intent to terminate the plan.

Following a QTA's determination of abandonment, the QTA must provide notice to the DOL of its finding of abandonment and its intent to serve as a QTA. Again, the regulations provide a model notice for this purpose. The plan will be deemed terminated 90 days after the administrator furnishes this notice to the DOL, unless the DOL objects to the termination or waives the 90-day period.

After a deemed termination occurs, a QTA must take certain specific steps to wind up the affairs of the plan and distribute benefits. The regulations specify the standards that will apply to several of the QTA's required activities. These steps include:

1. Making reasonable efforts to locate and update plan records necessary to determine benefits payable to participants.

2. Calculating the benefits payable to participants based on plan records.

3. Engaging necessary service providers to wind up the affairs of the plan and distribute benefits.

4. Paying reasonable expenses associated with the QTA's authority and responsibilities.

5. Notifying plan participants of the termination and their ability to elect a distribution.

6. Distributing benefits in accordance with the elections received from participants.

7. Filing a terminal report for the plan. (Proposed reporting regulations are described more fully below.)

8. Filing a final notice of termination with the DOL.

Importantly, the regulations specifically limit the liability of QTAs. The regulations provide that if a QTA carries out its termination responsibilities in accordance with the regulation, the QTA is deemed to satisfy its responsibilities under section 404(a) of ERISA, except with respect to the selection and monitoring of service providers. In the latter situation, if the QTA selects and monitors service providers consistent with ERISA's general prudence rules, the QTA will not be held liable for the acts and omissions of service providers with respect to which the QTA has no knowledge.

What about IRS compliance issues? (Some time ago, IRS was reportedly considering a position that abandoned plans were not qualified, because they were no longer "maintained by an employer," but this was never finalized in any way.) The Preamble (70 Fed. Reg. at 12050) indicates that IRS has given its blessing to the program subject to the following 3 conditions (which apparently do not include amending the plan for all currently applicable requirements).

1. The QTA makes a reasonable determination of whether the survivor annuity rules apply (and, presumably, administers compliance with them if they do apply).

2. Each participant and beneficiary is fully vested in their accounts.

3. Each participant and beneficiary receives a Code section 402(f) rollover notice.

IRS nevertheless reserves the right to pursue appropriate remedies against parties responsible for the plan such as the business owner, plan sponsor or plan administrator.

B. <u>Safe Harbor Regulation for Participants Who Fail to Make an Election</u>

The regulations acknowledge that not all participants will provide distribution elections in response to notices from the QTA. DOL states that if notices are returned to the QTA as undeliverable, the QTA must take steps consistent with its general fiduciary obligations to locate and notify missing participants of their entitlement before distributing benefits. To ensure compliance with ERISA, DOL states that the QTA should follow DOL's Field Assistance Bulletin 2004-2 on missing participants.

In addition, for those participants who fail to provide distribution elections in a timely manner, the proposed regulations establish that the individual's benefit generally must be rolled into an individual retirement account or annuity. Proposed Safe Harbor Rollover Regulations, 29 C.F.R. § 2550.404a-3. Because the selection of an IRA provider, and the investment options in which IRA assets are invested, are fiduciary functions, the DOL was concerned that financial institutions would not perform these tasks because of potential liability in connection with these determinations. Accordingly, DOL has proposed a safe harbor regulation through which a QTA would be deemed to satisfy its fiduciary obligations in connection with the selection of an IRA provider, and the investment of distributed funds, for participants who fail to make distribution elections. This safe harbor mirrors the recently finalized safe harbor regulation for automatic rollovers of mandatory distributions under section 401(a)(31)(B) of the Code by requiring these distributions to be invested in a product designed primarily to preserve principal. 29 C.F.R. § 2550.404a-2.

In developing the safe harbor regulation, DOL determined that relief should not be limited to QTAs terminating abandoned plans. Accordingly, the proposed safe harbor relief is available to fiduciaries in connection with rollover distributions from any terminating defined contribution plan whenever a participant fails to elect a distribution option.

C. <u>Proposed Reporting Requirements</u>

Under the regulations, QTAs are required to file a terminal report for an abandoned plan within two months following the distribution of the plan's assets. A separate proposed regulation addresses the content, timing, and method of filing for the terminal report. Proposed Reporting Regulation, 29 C.F.R. § 2520.103-13. The terminal report provides information such as the total assets of the plan as of the termination date and the amount of termination expense paid by the plan. Importantly, the regulation provides that the QTA is not subject to the generally applicable reporting requirements of ERISA, other than the requirement to file the terminal report. Therefore, the QTA will have no liability to satisfy any of the plan administrator's reporting obligations, such as the Form 5500.

D. <u>Proposed Class Exemption</u>

DOL also published a proposed exemption that provides relief for the following transactions: (1) the QTA's selection of itself or an affiliate to provide services in connection with the termination of a plan, (2) for participants who fail to elect a distribution option, the QTA's selection of itself or an affiliate as an individual retirement plan provider, (3) the investment of distributed assets on behalf of non-responsive participants in proprietary investment products of the QTA or an affiliate, and (4) the receipt of fees by the QTA in connection with these transactions. 70 Fed. Reg. 12074 (Mar. 10, 2005).

Relief for the QTA's selection of itself to provide termination services is subject to two conditions: fees paid to the QTA must be consistent with industry rates for similar services, and may not exceed fees charged by the QTA for similar services provided to customers that are not plans terminated pursuant to the abandoned plan regulations. Exemptive relief for the QTA's selection of itself to receive rollover distributions is subject to a number of conditions that closely track the requirements of the proposed safe harbor regulation. Notably, unlike the safe harbor regulation, the exemption limits the ongoing fees that may be charged to the IRA to the income earned by the account. We note that a similar condition was included in the proposed DOL regulations for automatic rollovers, but was dropped in response to significant negative comment from the industry. We expect that the reappearance of this restriction in the abandoned plans exemption will again engender substantial negative comment from IRA providers unwilling to open accounts subject to such a limitation.