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FINANCIAL SECURITY FOR LIFE

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5669
U.S. Department of Labor
Washington, D.C. 20210

Attn: Automatic Rollovers RFI

Dear Sir or Madam:

On behalf of the American Council of Life Insurers ("ACLI"), I am writing to provide information in response to the Employee Benefits Security Administration's (EBSA's) Request for Information published in the Federal Register January 7, 2003 with respect to the need to establish safe harbors relating to the automatic rollovers of certain involuntary tax-qualified plan distributions to individual retirement plans.

ACLI represents the interests of more than 380 life insurers with millions of policyholders. Our member companies provide life insurance, annuities, pensions, long-term care insurance, disability income insurance, individual retirement accounts and individual retirement annuities, and other retirement and financial protection products designed to help Americans plan for and achieve retirement security. Insurers hold one-fifth of the privately administered retirement assets in the United States - approximately $1.8 trillion.

Pursuant to Internal Revenue Code ("Code") section 401(a)(31)(B), tax-qualified retirement plans are permitted to make an immediate distribution to a separating participant, without the participant's consent, if the present value of the participant's vested accrued benefit does not exceed $5,000. Section 657 of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") amended Code section 401(a)(31)(B) to provide that if such a mandatory distribution of more than $1,000 is made and the distributee does not elect to have such distribution paid directly to an eligible retirement plan or receive the distribution directly, the plan administrator must transfer such distribution to an IRA of a designated trustee or issuer.

The Department of Labor (DOL or the Department) had advised Treasury and IRS with respect to their issuance of Revenue Ruling 2000-36, approving a plan amendment that permitted a direct rollover to an IRA as the default distribution option for an involuntary cash-out of a qualified plan distribution, that, under Title I of ERISA, in such a default direct rollover, the participant would cease to be a participant covered under the plan where the distribution constitutes the entire benefits of a participant and the distributed assets would cease to be plan assets (see footnote 1 to Revenue Ruling 2000-36). However, DOL also noted that the selection of an IRA trustee, custodian or issuer and IRA investment for purposes of such a rollover would constitute a fiduciary act subject to the general fiduciary standards and prohibited transaction provisions of ERISA.

Pursuant to section 657(c) of EGTRRA, within three years after the date of enactment, DOL was directed to develop safe harbors, under which the designation of an institution and the investment of funds by a plan administrator to receive automatic rollovers as described in Code section 401(a)(31)(B) would be deemed to satisfy the fiduciary requirements of ERISA section 404(a). Until the Department of Labor issues the safe harbor regulations, the provisions requiring all tax-qualified plans to make automatic rollovers to IRAs the default option for involuntary distributions of certain defined amounts will not become effective.

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In promulgating rules to satisfy this statutory requirement, ACLI urges EBSA to adopt rules that make automatic rollover accounts simple to administer and maintain in order to maintain their viability. These accounts will be small in dollar amount, between $1,000 and $5,000 with no requirement or expectation that further contributions will be made. As a result, complicated rules with respect to their establishment, investment or maintenance will necessarily result in few available providers and high fees that will quickly deplete the value of these accounts to the detriment of their owners.

Unless the requirements are simple and administrable, EBSA could eliminate the willingness of most providers to offer accounts in this market, thereby forcing plan sponsors to eliminate the involuntary distribution provisions in their plans and complicating and increasing the cost of plan administration.

With respect to the specific requests for information, ACLI provides the following information that we hope will be helpful to the Department of Labor and EBSA in establishing the requirements for automatic rollover accounts:

1. Standards for Safe Harbor Entity

ACLI recommends that DOL permit any entity that is an available IRA provider (satisfying the conditions set forth in Treas. Reg. sections 1.408-2(b) and 1.408-3(a) and (b)) be considered as a potential safe harbor entity. Making the standard as broad as possible will promote competition, resulting in the lowest fees possible related to the administration of these accounts. Limiting the entities to current IRA providers should be deemed sufficient to satisfy the requirements of ERISA section 404(a).

Currently, it is difficult to find an IRA account without a minimum deposit or ongoing contribution requirement. Because automatic rollover accounts will only be between $1,000 and $5,000 with no guarantee of recurring contributions, it may be very difficult to find many (or any) IRA providers or products that will offer products in this limited market. Accordingly, ACLI requests DOL to provide streamlined rules for these activities in order to ensure adequate providers of automatic rollover accounts. The standard should be the same for both IRA accounts and IRA annuities in order to provide the broadest availability of options.

EBSA specifically asks whether IRA providers that are existing plan service providers should receive any special consideration if plan investments can be rolled directly in-kind without transaction fees for liquidating plan investments and purchasing IRA investments. In response to DOL's question, ACLI does not believe that a no-cost automatic rollover to an IRA is viable for these small amounts. ACLI further believes that this would not be a viable option for many insurance products that use different separate accounts for various lines of business (particularly ERISA plans vs. non-ERISA plans) because transferring assets in-kind between separate accounts requires the approval of one's domiciled state insurance department. This is a very labor-intensive and costly process and would make such an option impractical in light of the small size of these automatic rollover accounts. The 'service model' on an individually owned account is entirely different from the 'service model' applied for a group retirement program. DOL seems to be suggesting a new 'service model' here, but there are not assets sufficient to justify building it. For these mandatory rollover IRAs, providers would need to establish new, individual accounts, mail new materials and confirms, continue to mail statements, mail IRA disclosure documents, complete 5498's and continue to try to get the "owner's" attention and provide certain information (e.g., designate a beneficiary).

In fact, for certain annuity investments, it would not even be necessary to force a rollover distribution of these involuntary distributions. For example, there is no need to force a distribution and require an automatic rollover to an IRA where certain 403(b) contracts exist that are subject to ERISA. In such situations, the contract itself could be distributed to the individual. A similar approach also works for certain group deferred annuity (GDA) or retention products used in certain section 401(k) plans where the individual participant's account value is governed by the terms of a certificate issued to that participant that would permit the participant to subsequently move the funds to an IRA, if desired. The benefits of such an approach include maintaining the "status quo" in the participant's investments (i.e., not forcing them out of their current investments) as well as eliminating surrender charges. No additional administrative handling fees would be incurred, and certain plan features, such as loans, could be retained. Pursuant to Treasury regulation section 1.402(a)-1(a)(2), where an annuity contract purchased for an individual with a cash surrender value is distributed to the employee, the value will not be considered income to the employee unless and until the contract is actually surrendered, so that there are no immediate adverse tax consequences to the individual participant. Accordingly, ACLI suggests that the DOL specifically provide that where such an annuity distribution approach is available, this option be treated as satisfying the automatic rollover requirement.

ACLI also suggests as an additional option, the employer be permitted to choose a single IRA provider that would become the preferred provider potentially reducing fees and making it more appealing to the provider to offer those arrangements because it increases the chance that the provider will retain larger rollovers. This alternative should not be an exclusive option because not all IRA providers would consider, or be able, to participate in such an arrangement. ACLI recommends that DOL provide that such an arrangement would not constitute an endorsement of the IRA provider by the plan sponsor. Such an arrangement would permit direct transfers that would not be subject to the 20% withholding rule, making such a transaction simpler for both the plan sponsor and the participant.

2. *Standards for Safe Harbor Initial Investment*

The guiding principle in determining appropriate investments for safe harbor automatic rollover accounts should be the preservation of principal for their owners. In order to ensure the lowest fees possible for establishing and maintaining automatic rollover accounts, simplicity should govern their initial investment. Examples of appropriate investments for automatic rollover accounts include a fixed annuity with a General Account investment or a variable annuity with a General Account option or money market account, at the election of the plan sponsor. A fixed annuity would keep costs lower since they are not registered investments under the securities laws subject to expensive requirements related to providing prospectuses, annual reports, etc.

Use of guaranteed investments could result in harm to participants in certain situations. For example, assume that a participant's account had been more than $5,000, but as a result of poor investment performance, the value of the account falls just slightly below $5,000. The plan sponsor involuntarily cashes out the account and rolls over the balance into an automatic rollover IRA that contains a guaranteed investment with little growth potential. Subsequent to the transfer, the investment performance in the plan improves, but this participant does not get to recoup the loss of his account because it has been rolled over into an automatic rollover account However, if recouping a loss is important to the participant, the participant has the opportunity to make an affirmative election with respect to his or her account. The policy underlying the involuntary cash-out provision is that plan sponsors need the ability to reduce costs and ease administration; thus, plan sponsors are afforded the option to cash-out small accounts for terminated participants. The revised legislation is based upon improvements in portability and the desire to minimize "leakage". However, participants need to retain responsibility for their retirement savings. Therefore, we urge the Department to clarify that if a participant does not make an affirmative election, the employer should only be obligated to minimize the risk of loss to such participant by transferring that participant's account to a fixed annuity or money market account, or similar investment.

As noted above, the use of annuity contracts as investments in the underlying plan could eliminate the need for safe harbor entities or investments in certain situations where automatic rollovers would not be necessary. ACLI specifically requests the DOL regulations to sanction such an approach and provide that maintaining the investment options previously selected by the plan participant will be a safe harbor investment selection by the plan fiduciary. In such a situation, the plan fiduciary would have the choice of maintaining the current investment options selected by the plan participant or selecting a non-registered fixed investment for the distributed annuity.

3. Establishment costs, termination costs, maintenance fees, investment fees, and surrender charges and other costs or fees

Until EBSA establishes particular safe harbors and there is a better sense of who would be safe harbor providers and what investments would be considered safe harbor investments, it would be very difficult to provide a range of costs and fees. For example, if EBSA requires mirror investments to those in the underlying plan and those investments include securities, then the costs incurred would have to include the costs of sending out prospectuses and other documents required under the securities law, adding to the costs of administration. On the other hand, a fixed annuity [or bank CD] would result in lower fees because it would not be subject to such securities law requirements, would have less administration costs, be simpler to set up and maintain, would require no performance reports and would have lower, or no, investment management fees.

Because of the small size of these accounts, the costs and fees of establishing and maintaining them may frequently be disproportionate to their size. However, ACLI does not believe that the fees associated with automatic IRAs should be artificially limited by having the plan or plan sponsor absorb them; rather, the fees should be set by the marketplace. Establishing a rule that charged the IRA establishment costs against the distributing plan would encourage plan participants not to take any action with respect to automatic rollovers which result would appear to be contrary to public policy. As long as sufficient notice is provided to participants of their options, if a participant does not make an affirmative election, the plan should not be charged for the IRA establishment costs.

With respect to the question posed by EBSA in the request for information as to whether IRA principal should be guaranteed with all investment fees, maintenance fees and establishment costs being charged to investment earnings, ACLI believes that it is unrealistic to ask providers, in this size market, to guarantee a certain level of investment returns. If, however, a fixed annuity with a General Account option and/or a money market fund is used, then principal should be preserved and costs minimized.

With respect to EBSA's suggestion that refund or waiver features be considered in determining whether an IRA provider or initial investment qualifies for safe harbor treatment, again, ACLI believes that it is unrealistic to believe that providers would offer such automatic rollover accounts at no cost for a year. Again, such a rule would encourage participants to take no action; instead DOL should encourage participants to take appropriate steps with respect to their retirement accounts and make affirmative elections with respect to automatic rollover accounts.

4. Prohibited Transaction Relief

ACLI believes that prohibited transaction relief is critical in ensuring that sufficient IRA providers are available to this automatic rollover market. Prohibited transaction relief should be provided to IRA providers so that they may offer the automatic rollover accounts to their own plans and to customers' plans. By permitting such transactions, DOL may increase the number of available providers for automatic rollover IRAs. However, ACLI believes that prohibited transaction relief should be granted so long as the fees and charges on these accounts do not exceed the fees and charges applicable to any other IRA holder in the same investment option with a similar sized account. ACLI also believes that IRA providers should be held harmless in the event the accounts are depleted as a result of fees and/or market decline.

Plan sponsors should be relieved of fiduciary liability as long as they choose one of the safe harbor entities and invest in a safe harbor investment.

5. Legal Impediments

With respect to the use of insurance products, such as annuities, an issue may arise with respect to the state insurance departments that generally require participant consent for the transfer of the annuity contract. State insurance departments may require an application with a participant's signature to issue an annuity contract.

A number of federal and state securities issues arise relating to the transfer of assets from an Internal Revenue Code section 401(k) plan that enjoys certain securities law exemptions to an IRA that does not enjoy those same exemptions. Unless DOL can coordinate this matter with the Securities and Exchange Commission, DOL should provide for a safe harbor that exempts these accounts from these requirements and significant expenses that would be borne by the IRA owners.

Additionally, the anti-money laundering regulations require financial institutions to "know their customers" so that this default rollover may well present problems for any financial institution offering automatic rollover accounts.

ACLI believes that some of these automatic rollover accounts will belong to "missing participants," especially because of their small size. This issue will be of particular concern to the financial institutions that would consider offering such "automatic rollover" products. The Department of Labor will need to provide guidance on the manner in which to deal with such "missing participants" and their accounts. We are happy to work with the Department as it develops guidance on this issue.

6. Disclosure

We believe it is critical to provide adequate notice to affected participants and provide them with sufficient time prior to the occurrence of the rollover to permit them to make a reasoned and informed decision. The notice would provide details of the safe harbor entity and investment and advise participants that unless they choose another option, their account will be automatically rolled over into this account. If a participant is provided such notice and does not respond, such failure should be treated as a "negative consent" to the automatic rollover and provide ERISA section 404(c) protection against fiduciary breaches to the plan sponsor and to the IRA provider as long as safe harbor entities and investments are selected. The notice should also provide disclosure with regard to fees and charges applicable to the automatic rollover option; if this is a generally available product, there will be appropriate marketing materials that can easily be provided.

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We appreciate this opportunity to respond to the request for information. If you would like to discuss any of these issues further, please do not hesitate to contact me at (202) 624-2150.

Sincerely yours,

Rhonda Migdail

Rhonda Migdail

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cc: Ann L. Combs, Assistant Secretary, EBSA, U.S. Department of Labor