Comments on Automatic Portability Transaction Regulations

Docket Number: EBSA-2024-0001

I am writing to comment on the proposed rule 2024-01208 that would implement the statutory prohibited transaction exemption under Code section 4975(d)(25) for certain automatic portability transactions. I appreciate the Department of Labor's efforts to facilitate the automatic transfer of retirement savings from one employer-sponsored plan to another when a worker changes jobs, and to provide a prohibited transaction exemption for the fees and compensation received by an automatic portability provider that performs the transfer services.

However, I have some thoughts on the proposed rule.

Fees and compensation

The proposed rule does not seem to specify the amount or structure of the fees and compensation that the automatic portability provider can receive for the services provided in connection with the automatic portability transaction. This could create uncertainty and inconsistency in the pricing and quality of the services, as well as potential conflicts of interest or incentives for the automatic portability provider to favor certain destination plans or transfer methods. These fees, after all, are for non-consent actions, and are not entered into with the full knowledge and consent of the worker.

I understand that the SECURE 2.0 provision stipulates that an automatic portability provider's fees "shall not exceed reasonable compensation and must be approved in writing by the plan fiduciary," and thus there are some controls in place to prevent excessive fees. Furthermore, employees are given at least 60 days notice of an automatic-portability transaction and have the ability to opt out. But in the real world, people don't always see or understand or grasp the significance and implications of such notices.

As a result, I suggest that the Department of Labor provide more guidance or standards on the fees and compensation that the automatic portability provider can receive, such as the maximum or reasonable amount, the frequency or timing, the source or payer, the disclosure or transparency, and the relation or proportion to the value or benefit of the services. This would help to ensure that the fees and compensation are fair, reasonable, and consistent, and that they do not adversely affect the interests of the participants or the plans. Perhaps a cap on such fees might be appropriate under the circumstances.

Participants' rights and benefits

The proposed rule does not address how the automatic portability transactions would affect the participants' rights and benefits under the transferring plan and the receiving plan, such as vesting, matching contributions, investment options, fees, distributions, loans, and hardship withdrawals.

As I understand it, participants in retirement plans have rights under ERISA, including right to disclosure of important plan information and a timely and fair process for benefit claims. It is reasonable to expect that these rights would be upheld in the context of automatic portability transactions.

Nevertheless, I suggest that the Department of Labor consider providing more guidance or examples on how the automatic portability transactions would affect the participants' rights and benefits under the transferring plan and the receiving plan, and how the automatic portability provider should communicate and coordinate with the plan sponsors, fiduciaries, and destination plans to ensure that the participants' rights and benefits are protected and preserved. This would help to avoid any loss or reduction of the participants' rights and benefits, and to enhance the participants' choice and control over their retirement savings.

Conditions and safeguards

The proposed rule does not provide sufficient detail or examples on how the automatic portability provider should comply with the conditions and safeguards of the prohibited transaction exemption, such as the independence requirement, the written agreement requirement, the opt-out opportunity requirement, the recordkeeping requirement, and the audit requirement. This could create ambiguity and inconsistency in the implementation and enforcement of the exemption, as well as potential risks or challenges for the participants, plan sponsors, fiduciaries, and automatic portability providers.

It is true that the proposed regulation, reflecting SECURE 2.0, stipulates that an automatic-portability provider must acknowledge in writing that it is a fiduciary on auto-portability transactions.

Even so, I suggest that the Department of Labor may wish to consider providing more detail on how the automatic portability provider should comply with the conditions and safeguards of the prohibited transaction exemption, such as the criteria or methods for demonstrating the independence of the automatic portability provider, the content or format of the written agreement between the automatic portability provider and the plan sponsors or plan administrators, the timing or manner of providing the opt-out opportunity to the participants, the types or formats of the records and reports to be maintained and provided by the automatic portability provider, and the objectives or scope of the audit to be conducted by the independent auditor. This would help to ensure that the conditions and safeguards are clear, consistent, and effective, and that they protect the interests of the participants and the plans.

Saver's credit

The proposed rule does not seem to explain how the automatic portability transactions would affect the participants' eligibility for the saver's credit under Code section 25B, which is a nonrefundable tax credit for low- and moderate-income workers who contribute to a retirement plan. This could create confusion and complexity for the participants, plan sponsors, fiduciaries, and automatic portability providers regarding the tax benefits of the transfers.

While one would expect that the saver's credit benefits should be preserved in the context of automatic portability transactions, it might be helpful to have this made more explicit.

As a result, I suggest that the Department of Labor confirm in the rule how the automatic portability transactions would affect the participants' eligibility for the saver's credit under Code section 25B, and how the automatic portability provider should communicate and coordinate with the participants, plan sponsors, fiduciaries, and destination plans to ensure that the participants' eligibility for the saver's credit is not adversely affected by the transfers. This would help to preserve the tax benefits of the participants and to encourage the participation and contribution to the retirement plans.

Spousal consent and beneficiary designation

The proposed rule does not address how the automatic portability transactions would interact with the existing rules and requirements for spousal consent and beneficiary designation under the Internal Revenue Code and the Employee Retirement Income Security Act. This could affect the participants' rights and obligations regarding their retirement savings and the protection of their spouses and beneficiaries.

I understand that under ERISA and IRC rules, if a participant is married at the time of death, the participant's spouse is automatically the beneficiary of the participant's account balance under the plan. However, the rule could more clearly acknowledge this and other key aspects of spousal consent and beneficiary designation.

Therefore, I suggest that the Department of Labor consider and possibly address in the rule how the automatic portability transactions would interact with the existing rules and requirements for spousal consent and beneficiary designation under the Internal Revenue Code and the Employee Retirement Income Security Act, and how the automatic portability provider should communicate and coordinate with the participants, plan sponsors, fiduciaries, and destination plans to ensure that the spousal consent and beneficiary designation are respected and maintained. This would help to protect the rights and interests of the spouses and beneficiaries and to avoid any legal or financial complications.

Monitoring and enforcement

The proposed rule does not appear to provide clear guidance on how the Department of Labor would monitor and enforce the compliance with the conditions and safeguards of the prohibited transaction exemption, such as the independence requirement, the written agreement requirement, the opt-out opportunity requirement, the recordkeeping requirement, and the audit requirement. This could create ambiguity and inconsistency in the implementation and enforcement of the exemption, as well as potential risks or challenges for the participants, plan sponsors, fiduciaries, and automatic portability providers.

I understand that the proposed rule stipulates that an automatic-portability provider must acknowledge in writing that it is a fiduciary on auto-portability transactions. However, I suggest that the Department of Labor provide clear guidance on how the Department of Labor would monitor and enforce the compliance with the conditions and safeguards of the prohibited transaction exemption, such as the procedures or mechanisms for reviewing and verifying the records and reports provided by the automatic portability provider, the criteria or methods for evaluating and assessing the performance and quality of the automatic portability provider, the actions or sanctions for addressing and correcting any violations or deficiencies by the automatic portability provider, and the avenues or channels for receiving and resolving any complaints or disputes from the participants, plan sponsors, fiduciaries, or destination plans. This would help to ensure that the exemption is implemented and enforced in a fair, consistent, and effective manner, and that any issues or problems are promptly and properly addressed.

Escheat (unclaimed property) related issues

The proposed rule does not directly address the issue of escheat laws, which are state laws that govern the transfer of unclaimed property to the state when the owner cannot be located or contacted. Unclaimed property can include uncashed checks, dormant bank accounts, stocks, bonds, insurance policies, and retirement accounts.

The proposed rule may have some implications for the treatment of unclaimed retirement accounts. The proposed rule would create a framework for the automatic transfer of retirement savings from one employer-sponsored plan to another when a worker changes jobs, without the need for the worker's consent or intervention. This would reduce the likelihood of retirement accounts becoming unclaimed or abandoned due to job changes, missing participants, or uncashed checks.

However, the proposed rule would not eliminate the possibility of retirement accounts being subject to escheat laws in some circumstances. For example, if a worker does not change jobs for a long period of time, or if the automatic portability provider cannot locate or contact the worker or a suitable destination plan, the retirement account may still be considered unclaimed or abandoned under state law. In such cases, the plan sponsor or fiduciary would have to comply with the applicable state escheat laws and report and remit the unclaimed property to the state.

The escheatment of a retirement account to a state unclaimed property fund could have adverse tax and legal consequences for the worker and the plan. According to IRS Guidance, the escheatment of an IRA or annuity to a state unclaimed property fund will be treated as a designated distribution to the IRA owner subject to withholding at a 10% rate. This means that the IRA owner will have to report the escheated amount as taxable income and pay any applicable taxes and penalties. If the IRA owner later reclaims the escheated amount from the state, they may be able to roll it over to another IRA or eligible retirement plan within 60 days of receipt, subject to certain conditions and limitations. However, the rollover will not undo the tax consequences of the escheatment, and the IRA owner will have to use other funds to make up for the 10% withholding.

The escheatment of a retirement account to a state unclaimed property fund could also affect the fiduciary responsibility and liability of the plan sponsor and the plan administrator. Some plan sponsors and administrators have expressed concerns about their fiduciary obligations to locate and communicate with missing participants, and their potential exposure to legal challenges or penalties for failing to do so. Some plan sponsors and administrators also have indicated that they would prefer to transfer the unclaimed retirement accounts to the PBGC's missing participants program, which is a centralized repository for the retirement benefits of missing participants from terminated defined benefit and defined contribution plans. However, the PBGC's program is not available for ongoing plans, and the proposed rule does not address whether the automatic portability provider could transfer the unclaimed retirement accounts to the PBGC's program instead of the state unclaimed property funds.

Therefore, the proposed rule may reduce the incidence of escheatment of retirement accounts, but it would not override or preempt the state escheat laws. The plan sponsors and fiduciaries would still have to follow the state laws and regulations regarding unclaimed property and exercise due diligence to locate and contact the missing participants or beneficiaries.

I suggest that the Department of Labor consider and possibly address the issue of escheat laws in the proposed rule, and provide more guidance or options for the plan sponsors, fiduciaries, and automatic portability providers to deal with the unclaimed retirement accounts. This would help to avoid or minimize the tax and legal consequences of escheatment, and to protect the interests and benefits of the workers and the plans.

Thank you for considering my comments on the proposed rule.

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