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Change in Treatment of Cash-Out Distributions – Automatic Rollovers

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Currently, when a participant in a tax-qualified retirement plan separates from employment with an employer, if the value of the participant's vested benefit under the Plan is not greater than $5,000, the plan may automatically distribute the benefit to the participant without his consent. This involuntary distribution is commonly called a "cash-out distribution." If the participant elects, the cash-out distribution may be directly rolled over to another employer's tax-qualified retirement plan or to an IRA. However, if the participant does not make an election, the cash-out distribution will generally be paid directly to the participant and will be taxable unless the participant rolls it over to another employer's tax-qualified retirement plan or to an IRA within 60 days.

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") imposed a new automatic rollover requirement on plan administrators with respect to cash-out distributions, but its effective date was delayed until final regulations were issued. The final Department of Labor regulations were issued on September 28, 2004 with an effective date of 6 months following their issuance. Thus, the new rule regarding automatic rollovers applies to any cash-out distribution made on or after March 28, 2005. Under this rule, in the absence of an affirmative election by a participant to receive a direct payment, cash-out distributions of between $1001 and $5000 *must* be rolled over to an IRA established for the participant. Although plans are not required to automatically roll over cash-out distributions that are less than $1001, plan fiduciaries may rely on the regulations with respect to such distributions.

Fiduciary Duties of Plan Administrators

In establishing an IRA for a participant, a plan administrator must choose an IRA provider and select an investment in which the amount of the distribution will be initially invested. In connection with these activities, the plan administrator has fiduciary duties under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). If a plan administrator satisfies all of the five safe harbor requirements contained in the final regulations, the fiduciary duties of the plan administrator under ERISA will be deemed satisfied with respect to the automatic rollover of a participant's cash-out distribution.

Safe Harbor Requirements

There are five safe harbor requirements under the regulations:

1. Amount

The value of the automatic rollover cannot exceed the amount that may be distributed without the participant's consent. This amount is currently $5,000. Thus, if as permitted, a plan

provides that cash-out distributions may be determined without reference to a participant's rollover contributions, the maximum amount of the automatic rollover cannot exceed $5,000 plus the amount of the participant's rollover contributions and any earnings thereon.

2. IRA

The distribution must be rolled over into an individual retirement plan, which is defined as an individual retirement account or an individual retirement annuity.

3. Written Agreement

The plan administrator must enter into a written agreement with the IRA provider specifically addressing, among other things, the investment of the rollover funds and the fees and expenses associated with the IRA into which such funds are deposited. To the extent that the terms and conditions of the written agreement comply with the safe harbor regulations, the fiduciary duties of the plan administrator will be deemed to have been satisfied. Thus, once the agreement is signed and the rollover is completed, the plan administrator will not be obligated to monitor the IRA provider's compliance with the agreement and the plan administrator's fiduciary obligation with respect to the automatic rollover will end.

Investment Products

The rolled over amount must be invested in an investment product offered by a state or federally regulated financial institution that is designed to preserve principal and provide a reasonable rate of return (whether or not such return is guaranteed) consistent with liquidity. Examples of permissible investments would include money market funds maintained by registered investment companies, interest bearing savings accounts and certificates of deposit of a bank or a similar financial institution, and certain stable value products issued by a regulated financial institution.

Fees and Expenses

The fees and expenses associated with the IRA may not exceed the fees and expenses charged by the IRA provider for comparable IRAs that are not established to hold automatic rollover distributions.

4. Notice to Participants

Prior to implementing the automatic rollover rules, participants must be provided with a summary that describes the automatic rollover process. The summary must include (a) an explanation that the automatic rollover will be invested in an investment product designed to preserve principal and provide a reasonable rate of return and liquidity, (b) an explanation of how fees or expenses will be allocated (*i.e.*, the extent to which expenses will be borne by the account holder alone or shared with the distributing plan or plan sponsor), (c) the name, address and phone number of a plan contact person who can provide additional information regarding the plan's automatic rollover provisions and the name of the provider of the IRA into which the automatic rollover will be deposited and (d) the fees and expenses relating to the IRA.

5. Prohibited Transaction

The plan administrator may not engage in any prohibited transaction in connection with the selection of an IRA provider or investment product, unless such actions are covered by a statutory or administrative exemption.

Action Required

In view of the March 28, 2005 effective date, it is essential that plan administrators prepare to implement these new requirements. In order to utilize the safe harbor provided under the regulations, plan administrators must select an IRA provider, enter into an agreement with such IRA provider and distribute to participants a summary plan description or summary of material modifications which includes all of the information required under the regulations. Alternatively, plan administrators may choose to avoid having to comply with the new automatic rollover requirements by amending their tax-qualified retirement plans to eliminate cash-out distributions of amounts greater than $1000.

If you have any questions or would like further information about this Alert, please call Norman J. Misher at (212) 903-8733; Allen J. Erreich at (212) 903-8769; Cheryl F. Burman at (212) 903-8770; or Gary Chase at (212) 903-8737.

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