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Employee Benefit Plan Review

Ask the Expert

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SECURE 2.0 Act: Auto-Portability

Q We are hearing about the auto-portability feature introduced by the SECURE 2.0 Act. What is it? As a plan sponsor and plan fiduciary, what should we be thinking about in determining whether to implement the feature for our 401(k)?

A The SECURE 2.0 Act of 2022 (SECURE 2.0) was signed into law on December 29, 2022. SECURE 2.0 introduced to the retirement landscape several new concepts. Beginning 12 months after the enactment of SECURE 2.0 (i.e., on December 29, 2023), retirement plans and retirement plan service providers will be allowed to offer automatic portability for default IRAs. This feature would allow the transfer of assets in an employee's default IRA to a new employer's plan when the employee changes jobs (the receiving plan).

This automatic portability feature is aimed at limiting "leakage" from retirement accounts, for example, when a participant cashes out their retirement savings and never deposits the savings into a new retirement plan. Leakage has become a more pronounced issue as average employee tenure has declined over the years.

SECURE 2.0 created a new prohibited transaction exemption covering the receipt of fees and compensation by an automatic portability service provider in connection with automatic portability transactions. Conditions of the exemption include the provision of certain disclosures and notifications and certain other requirements.

In particular, an automatic portability provider must:

- Acknowledge in writing that it is a fiduciary with respect to the default IRA;
- Not receive fees and compensation, directly or indirectly, that exceed reasonable compensation (such fees and compensation must be fully disclosed and approved in writing in advance of the portability transaction by a plan fiduciary that is independent of the portability service provider);
- Not market or sell data related to the IRA or to the participants of the receiving plan and offer automatic portability transactions on the same terms to any receiving plan.

In addition, an automatic portability provider must:

- Run a query to match default IRA owners to receiving plans on at least a monthly basis;
- Transfer the assets as soon as practicable after the liquidation of the IRA; and
- Not have nor exercise discretion to affect the timing or amount of the transfer other than to deduct the appropriate fees.

An automatic portability provider must also keep records for six years after each automatic portability transaction and conduct an annual

audit to demonstrate compliance and maintain a website that contains a list of all recordkeepers with respect to which the provider carries out automatic portability transactions and a list of all fees paid to the provider.

In addition, an automatic portability provider must provide to a default IRA owner both a pre-transaction notice and a post-transaction notice, which notices must be written in a manner calculated to be understood by the average person and must not include inaccurate or misleading statements.

A pre-transaction notice must be provided at least 60 days before an automatic portability transaction. In this pre-transaction notice, the automatic portability provider must provide to the default IRA owner:

- A description of the automatic portability transaction;
- A complete and accurate statement of all fees that will be charged and compensation that will be received in connection with the transaction;
- A clear and prominent description of the individual's right to opt out of the transaction as well as other available distribution options;
- The deadline by which the individual must make an election;
- The procedures for such election;
- A telephone number that the individual may call to make an election;
- A description of the individual's right to designate a beneficiary; and
- Any other information that the Secretary of Labor may require by regulation.

A post-transaction notice must be provided no later than three business days after an automatic portability transaction. The automatic portability provider must provide to the default IRA owner notice of the actions taken by the automatic portability provider, all information regarding the location and amount of any transferred assets, a statement of fees charged against the account by the portability provider or its affiliates in connection with the transfer, a telephone number of the automatic portability provider and any other information that the Secretary of Labor may require by regulation.

Selecting a default IRA provider continues to be a fiduciary act that is subject to ERISA's fiduciary duties. The benefit of forcing out from plan accounts with small balances are manifold – from reducing plan expenses and easing administration to reducing fiduciary liability. The auto-portability feature introduced by SECURE 2.0 takes the default IRA one step further by connecting default IRAs with another plan in which the default IRA owner participates. This feature could be helpful to the default IRA owner by aggregating the individual's assets into one convenient account. However, not all default IRA owners will prefer to have their accounts automatically rolled into a subsequent employer's plan. For example, because IRAs typically offer access to a wider array of products and services, default IRA owners seeking access to more investment options or services may not want their IRA assets rolled into a qualified plan.

An employer that sponsors a participant-directed qualified plan may wish to offer its participants the convenience of auto-portability. However, the considerations in connection with offering auto-portability to participants are different than those with respect to forcing out small account balances. For receiving plans, one benefit of auto-portability is the potential to increase the plan's assets, which may allow the plan to negotiate lower plan costs, such as administrative and investment fees. However, receiving plans will take on responsibility for the ported IRA assets, and sizeable plans tend to be larger targets for lawsuits.

Additionally, a receiving plan fiduciary must take on responsibility for approving in writing the fees and compensation disclosed by an auto-portability provider in connection with portability transactions. Such approvals will require the plan to have procedures for reviewing the disclosed fees and compensation and to determine whether to approve or not.

In short, because there is no safe harbor or other fiduciary relief for plans that accept default IRA assets pursuant to an auto-portability feature, a receiving plan should consider whether the potential risk that it takes on is outweighed by the potential benefits to the plan and its participants.

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