

New Technologies in Retirement Plan Administration

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Caplin & Drysdale Alert

In December 1998, the IRS issued proposed regulations that address the use of electronic media (such as e-mail, telephone systems, the Internet, and intranet systems) to provide certain notices and consents required with respect to distributions from retirement plans. At the same time, the IRS issued Notice 99-1 which provides guidance on the application of new technologies to certain other transactions.

In January 1999, the Department of Labor (the "DOL") issued a proposed regulation establishing a safe harbor that pension and welfare benefit plans may rely on with respect to the use of electronic media to satisfy certain disclosure requirements under ERISA.

This article summarizes the recent regulatory guidance on the application of new technologies to retirement plan administration and notes key concerns raised by comments submitted to the IRS and the DOL.

IRS Proposed Regulations and Notice 99-1

The IRS' proposed regulations provide standards for electronic delivery of a § 411(a)(11) notice (explaining the distribution options available under a plan and the right to defer distribution); a § 402(f) notice (explaining the tax treatment and options available with respect to eligible rollover distributions); and a § 3405(e)(10)(B) notice (explaining the right not to have income tax withheld from certain distributions (other than eligible rollover distributions)). The proposed regulations also amend the timing requirements for providing the § 411(a)(11) notice and the § 402(f) notice. In addition, the regulations provide standards under which a plan may accept the electronic transmission of participant consent to a distribution.

Electronic delivery of notices under § 402(f), 411(a)(11), and 3405(e). The proposed regulations do not classify particular electronic media as satisfying the notice requirements; instead, the regulations prescribe flexible standards applicable to any electronic media. These standards provide that notices may be given either on a written paper document or through an electronic medium so long as that medium is "reasonably accessible" to the participant. In addition, any electronic notice must be provided through a system "reasonably designed to provide the notice . . . in a manner no less understandable to the [participant] than a written paper document." Moreover, the participant must be advised that he or she is entitled to request and receive a written paper document, and that document must be provided at no charge upon request.

Under the preamble to the proposed regulations, an electronic notice does not have to be identical in form or content to a notice provided on a written paper document, but the electronic notice has to contain all the legally required information and be no less understandable than a written paper document. The IRS has indicated that notices provided through e-mail or a web site will generally satisfy the "no less understandable" requirement. On the other hand, oral delivery of a notice through a telephone system may or may not satisfy this standard, depending on the "amount and nature" of the information in the notice. More specifically, oral delivery of § 402(f) notices would apparently be precluded. By contrast, oral delivery of § 3405(e)(10)(B) notices could meet the no less understandable standard. Whether oral delivery of a § 411(a)(11) notice can satisfy that standard "will depend on the complexity of the plan distribution options."

The preamble to the proposed regulations indicates that posting a copy of the notice or including a "print" option in the system does not satisfy the requirement that a written paper notice be available upon request. Commentators have, however, criticized this position and have suggested that plans instead be allowed a choice of providing the ability to print out a notice or offering a written paper notice upon request.

While the proposed regulations have generally been well received by commentators, the examples illustrating the regulations have been criticized. Commentators have noted that these examples suggest the existence of requirements not found in the text of the regulations, including, for example, an implied requirement that conversations with a customer service representative be recorded. A number of examples also imply that a participant who changes his or her personal identification number ("PIN") may not proceed with the electronic transaction until the plan has sent a confirmation of the PIN change.

Timing requirement for providing notices. Very generally, under existing regulations, the § 411(a)(11) notice and the § 402(f) notice each must be provided no less than 30 days and no more than 90 days before the date of distribution, although a participant is permitted to waive the 30-day period. The proposed regulations provide that the notices will also be treated as timely provided if a plan provides the complete notices more than 90 days before distribution and then provides a summary of each notice within the 30/90-day period described above (with the participant able to waive the 30-day period). If the participant so requests after receiving the summary, the plan must also provide the full notices without charge no fewer than 30 days before the distribution (although again the 30-day period may be waived).

The summary of each notice must set forth the principal provisions of the full notice, advise the participant that the full notice is available without charge upon request, and refer the participant to the most recent occasion on which the notice was provided. If the full notice is contained within a larger document (e.g., a summary plan description ("SPD")), the summary must identify that document and indicate where the explanation is located within the document. The summary method of satisfying the timing requirement applies to notices provided through either a written paper document or an electronic medium.

As noted above, oral delivery of a complete § 402(f) notice is apparently precluded pursuant to the "no less understandable than a written paper document" requirement. However, according to the preamble, "the IRS and Treasury believe that the summary of the section 402(f) notice can be provided orally through a well designed telephone system in a manner no less understandable than a written paper summary." The preamble also includes an example of a summary § 402(f) notice that may be read over an automated telephone system. Commentators have questioned whether that notice is too long and complex for oral delivery, and have asked that a more concise summary notice be approved.

Commentators have also been critical of the requirement that the summary refer the participant to when and where the most recent complete notice was provided. They note that "when" will frequently be different for each participant (e.g., if the notices are part of an SPD furnished as employees commence employment) and that "where" will require updating the electronic system each time the larger document is amended. Commentators suggest the "when and where" requirements are unnecessary given the right to request a complete notice.

Consent under § 411(a)(11). The proposed regulations provide that a participant may consent to a distribution through an electronic medium "reasonably accessible" to the participant. The system through which consent is given must be "reasonably designed to preclude any individual other than the participant

from giving the consent." The system must also provide the participant with "a reasonable opportunity to review and to confirm, modify, or rescind the terms of the distribution before the consent to the distribution becomes effective." The preamble to the proposed regulations states that the review requirement is "not intended to require a mandatory rescission period"; it is sufficient for the plan to provide the "opportunity immediately before the participant completes the session in which the consent is given (for example, before exiting the plan web site or at the end of an automated telephone transaction)."

The system must also provide the participant a confirmation of the terms (including the form) of the distribution within a reasonable time after consent is given. The confirmation may be on a written paper document or through an electronic medium that meets the requirements applicable to notices. In fact, an electronic confirmation may be part of the same transaction in which consent is given; "[f]or example, the confirmation could be given immediately before completion of a session conducted on a plan web site."

Notice 99-1. Notice 99-1 provides that if no provision of Code § 401(a) or 401(k) (or the regulations or other guidance thereunder) sets forth rules or standards regarding the media through which a transaction may be conducted, a plan will not violate either Code section merely by using electronic media. In other words, a plan will not violate the qualification or 401(k) rules merely by using electronic media where existing guidance does not require a "written" notice, consent, election, or other document, and does not otherwise provide standards regarding the media to be used.

The Notice states that:

[s]uch transactions include (but are not necessarily limited to) enrolling in the plan, designating rates of elective and after-tax contributions, designating beneficiaries (other than designations requiring spousal consent), electing direct rollovers, electing investment allocations for future contributions, changing investment allocations for amounts held under the plan, inquiring about general plan information (such as investment options and distribution options), and inquiring about account information (such as current account balances and current investment allocations).

The Notice does not address the application of ERISA to the use of electronic media.

Other Notices, Consents, and Elections. The proposed regulations and Notice 99-1 do not provide guidance on the application of electronic media to a number of plan transactions.

Most prominently, the issued guidance does not address or apply to transactions involving an explanation of the qualified joint and survivor annuity or the qualified preretirement survivor annuity, or involving spousal consent under Code § 417. The proposed regulations and Notice 99-1 also do not address or apply to the use of electronic technologies with respect to participant loans, notices to interested parties (in connection with an application for a determination letter), notices under ERISA § 204(h), and notices associated with the § 401(k) and 401(m) safe harbors. Moreover, because Notice 99-1 is limited to Code § 401(a) and 401(k) plans, it does not apply to or provide guidance on the application of new technologies in the administration of section 457 and 403(b) plans.

It should be noted that while the proposed regulations permit electronic delivery of 3405 notices, the regulations are silent on electronic receipt of 3405 elections, i.e., elections made on Form W-4P (Withholding Certificate for Pension or Annuity Payments). However, in January 1999, the IRS issued Announcement 99-6, which permits electronic receipt of Form W-4P (and Forms W-4S and W-4V) through electronic systems that meet certain requirements.

Generally, the electronic system must ensure that the information received by the "payer" (as defined in Announcement 99-6) is the information sent by the payee and must make it "reasonably certain" that the person accessing the system and submitting the Form W-4P is the person identified on the form. The electronic submission must provide the payer with exactly the same information as a paper submission and be signed by the payee with an electronic signature that identifies the payee and authenticates the submission. The electronic signature must be the final entry in the submission. Moreover, upon request by the IRS, the payer must submit a hard copy of the electronic W-4P and a statement that to the best of the payer's knowledge, the named payee submitted the electronic W-4P.

Announcement 99-6 has been criticized with respect to certain issues, such as the requirement that the "electronic signature" be the final entry in the submission. One commentator has noted that in most electronic systems, an "electronic signature," such as a PIN number or password, is entered before the payee gains access to the electronic system. Electronic recordkeeping. Revenue Procedures 98-25 and 97-22, which are referred to in Notice 99-1, provide guidance to taxpayers generally (including employee plans) on the use of new technologies in keeping records required under the Code. Taxpayers that maintain records within Automated Data Processing Systems (accounting and/or financial systems that process all or part of a taxpayer's transactions, records, or data by other than manual methods) must generally comply with Rev. Proc. 98-25. Taxpayers that maintain their books and records through an electronic storage system that either images paper books and records or transfers computerized books and records to an electronic system must generally comply with Rev. Proc. 97-22.

DOL Proposed Regulations

Existing DOL regulations under ERISA 104 generally require a plan administrator to "use measures reasonably calculated to ensure actual receipt" of material that must be furnished to participants and beneficiaries under ERISA.

The existing regulations provide a safe harbor in which group health plans may rely in furnishing SPDs and summaries of material modifications ("SMMs") through electronic means. The rules that were proposed last January expand the safe harbor to all pension and welfare benefit plans covered by ERISA and to summary annual reports ("SARs"). The new proposed rules also establish standards for the maintenance and retention of plan records required by ERISA 107 and 209 in electronic form.

Proposed safe harbor. To fall within the proposed safe harbor, the plan administrator must take "appropriate and necessary measures to ensure that the system for furnishing documents results in actual receipt by participants of transmitted information and documents (e.g., uses [a] return-receipt electronic mail feature or conducts periodic reviews or surveys to confirm receipt of transmitted information)." The electronically delivered documents must be prepared and furnished in a manner consistent with the generally applicable

style, format, and content requirements under ERISA. In addition, each participant must be notified (either electronically or in writing) of the documents to be furnished electronically, the significance of the documents, and the participant's right to receive, free of charge, a paper copy of any document delivered through electronic media.

The proposed safe harbor is only available with respect to participants who have the ability at their worksite to effectively access documents furnished in electronic form and the opportunity at their worksite to readily convert furnished documents from electronic form to paper form free of charge. This generally makes the safe harbor unavailable in furnishing required material to non-employee participants and beneficiaries through electronic media, an issue addressed by numerous commentators.

In the preamble to the proposed regulations, the DOL states that, for purposes of the safe harbor, a worksite includes: any location where an employee is reasonably expected to perform his or her duties and where access to the employer's electronic information system is an integral part of those duties. In this regard, the Department believes that the actual location of the worksite (e.g., an employee's home, a client's office, or an employee's hotel room) is of less importance than the employee being reasonably expected to access the employer's information system in the course of performing his or her duties and, therefore, more likely to receive timely communication of plan information.

Commentators have asked that this provision be modified to permit reliance on the safe harbor where material is provided through a common computer station available to employees who do not have access to the employer's electronic system as part of their duties.

With respect to the requirement that participants be able to readily convert electronic information to paper copies at their worksite, the DOL "believes that this provision . . . may be satisfied by ensuring that participants have access to a printer at their principal worksite location."

With respect to the requirements that participants have the opportunity to print documents furnished electronically and the right to obtain a paper copy free of charge upon request, commentators have stated that the safe harbor should only require one of these to be satisfied and that the plan administrator should be able to choose which one. Also, commentators have asked that paper copies not be required to be identical to an electronic communication; such a clarification would be consistent with the IRS' position discussed above. Moreover, commentators have asked the DOL to consider deleting the requirement that administrators take steps to verify actual receipt of transmitted information.

Other Disclosure Obligations. The proposed rules do not extend the safe harbor to ERISA § 104(b)(2) (making certain plan materials available for examination by plan participants and beneficiaries) and ERISA § 104(b)(4) (responding to requests by participants and beneficiaries for copies of certain plan materials).

The proposed rules also do not address other potential uses of electronic media, such as the electronic delivery of individual benefit statements, COBRA notices upon a "qualifying event," or notices concerning qualified domestic relations orders or qualified medical child support orders. Other examples of issues not addressed include the electronic administration of plan loans and electronic payroll deduction agreements, or whether ERISA § 404(c) permits participants to give investment instructions and to receive information on

investment alternatives by electronic transmission.

Electronic recordkeeping. ERISA §§ 107 and 209 contain certain requirements relating to the maintenance of records for reporting and disclosure purposes and for determining the pension benefits to which participants and beneficiaries are or may become entitled. The proposed rule provides that electronic media may be used for purposes of complying with these record retention requirements.

Generally, the recordkeeping system must have reasonable controls to ensure the integrity, accuracy, authenticity, and reliability of the records kept. The records must be maintained in reasonable order, in a safe and accessible place, and in such manner that they may be readily inspected or examined. The records must also be legible and readable when displayed on a video terminal and be capable of being readily converted into legible and readable paper copy. Moreover, adequate records management practices must be established and implemented. In addition, the electronic recordkeeping system must not be subject to any agreement or restriction that would limit a person's ability to comply with ERISA requirements.

Original paper records may be disposed of at any time after they are transferred to an electronic recordkeeping system that complies with the above requirements, unless the original has particular legal significance or inherent value, e.g., notarized documents, insurance contracts, stock certificates, and documents executed under seal. The DOL has stated that a person's use of a third party to provide electronic recordkeeping services does not relieve the person of responsibility for the maintenance and retention of records.

It should be noted that the DOL is of the view that the proposed standards are not inconsistent with guidance issued by the IRS (*i.e.*, Rev. Procs. 98-25 and 97-22, which are discussed above) regarding the maintenance of records on an electronic storage system.

What Should Plan Sponsors Do?

Both sets of proposed regulations facilitate the use of new technologies in plan administration. The IRS' proposed regulations are proposed to be effective the first day of the first plan year beginning on or after the date that is six months after they are published as final regulations. The DOL's proposed regulations will be effective no earlier than the same date (determined with respect to final DOL regulations). In the interim, the preamble to the IRS' proposed regulations state that plan sponsors and administrators may rely on the proposed regulations. Pending final regulations, the Department of Labor has indicated that "good faith compliance with the standards set forth in [its] proposed regulations will . . . constitute compliance with a reasonable interpretation of [its regulations] and ERISA sections 107 and 209."

Plan sponsors and administrators who are already using the new technologies in plan administration should check their practices against the recent regulatory guidance, while those who are not using the new technologies may wish to consider doing so.

It is also very important that plan sponsors and administrators relying on the proposed regulations ensure that their plan documents are consistent with the use of new technologies. If plan operation is not consistent with the plan document with respect to the form and timing of notices and consents, this is a violation of the qualification requirements under the Code. Accordingly, timely plan amendments may be needed to reflect any changes in operation to reflect the new guidance. In this regard, plan sponsors may wish to consider providing themselves with flexibility in their plan documents, so that they can adjust to any future changes in

the law or in operation without further plan amendments. For example, a plan sponsor may wish to consider providing in its plan documents that all notice and consent requirements -- including those not addressed by the proposed regulations or Notice 99-1 -- may be satisfied in any manner permitted under the law. In December 1998, the IRS issued proposed regulations that address the use of electronic media (such as e-mail, telephone systems, the Internet, and intranet systems) to provide certain notices and consents required with respect to distributions from retirement plans. At the same time, the IRS issued Notice 99-1 which provides guidance on the application of new technologies to certain other transactions.

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The preamble to the proposed regulations indicates that posting a copy of the notice or including a "print" option in the system does not satisfy the requirement that a written paper notice be available upon request. Commentators have, however, criticized this position and have suggested that plans instead be allowed a choice of providing the ability to print out a notice or offering a written paper notice upon request.

While the proposed regulations have generally been well received by commentators, the examples illustrating the regulations have been criticized. Commentators have noted that these examples suggest the existence of requirements not found in the text of the regulations, including, for example, an implied requirement that conversations with a customer service representative be recorded. A number of examples also imply that a participant who changes his or her personal identification number ("PIN") may not proceed with the electronic transaction until the plan has sent a confirmation of the PIN change.

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The summary of each notice must set forth the principal provisions of the full notice, advise the participant that the full notice is available without charge upon request, and refer the participant to the most recent occasion on which the notice was provided. If the full notice is contained within a larger document (e.g., a summary plan description ("SPD")), the summary must identify that document and indicate where the explanation is located within the document. The summary method of satisfying the timing requirement applies to notices provided through either a written paper document or an electronic medium.

As noted above, oral delivery of a complete § 402(f) notice is apparently precluded pursuant to the "no less understandable than a written paper document" requirement. However, according to the preamble, "the IRS and Treasury believe that the summary of the section 402(f) notice can be provided orally through a well designed telephone system in a manner no less understandable than a written paper summary." The preamble also includes an example of a summary § 402(f) notice that may be read over an automated telephone system. Commentators have questioned whether that notice is too long and complex for oral delivery, and have asked that a more concise summary notice be approved.

Commentators have also been critical of the requirement that the summary refer the participant to when and where the most recent complete notice was provided. They note that "when" will frequently be different for each participant (e.g., if the notices are part of an SPD furnished as employees commence employment) and that "where" will require updating the electronic system each time the larger document is amended. Commentators suggest the "when and where" requirements are unnecessary given the right to request a complete notice.

Consent under § 411(a)(11). The proposed regulations provide that a participant may consent to a distribution through an electronic medium "reasonably accessible" to the participant. The system through which consent is given must be "reasonably designed to preclude any individual other than the participant

from giving the consent." The system must also provide the participant with "a reasonable opportunity to review and to confirm, modify, or rescind the terms of the distribution before the consent to the distribution becomes effective." The preamble to the proposed regulations states that the review requirement is "not intended to require a mandatory rescission period"; it is sufficient for the plan to provide the "opportunity immediately before the participant completes the session in which the consent is given (for example, before exiting the plan web site or at the end of an automated telephone transaction)."

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Notice 99-1. Notice 99-1 provides that if no provision of Code § 401(a) or 401(k) (or the regulations or other guidance thereunder) sets forth rules or standards regarding the media through which a transaction may be conducted, a plan will not violate either Code section merely by using electronic media. In other words, a plan will not violate the qualification or 401(k) rules merely by using electronic media where existing guidance does not require a "written" notice, consent, election, or other document, and does not otherwise provide standards regarding the media to be used.

The Notice states that:

[s]uch transactions include (but are not necessarily limited to) enrolling in the plan, designating rates of elective and after-tax contributions, designating beneficiaries (other than designations requiring spousal consent), electing direct rollovers, electing investment allocations for future contributions, changing investment allocations for amounts held under the plan, inquiring about general plan information (such as investment options and distribution options), and inquiring about account information (such as current account balances and current investment allocations).

The Notice does not address the application of ERISA to the use of electronic media.

Other Notices, Consents, and Elections. The proposed regulations and Notice 99-1 do not provide guidance on the application of electronic media to a number of plan transactions.

Most prominently, the issued guidance does not address or apply to transactions involving an explanation of the qualified joint and survivor annuity or the qualified preretirement survivor annuity, or involving spousal consent under Code § 417. The proposed regulations and Notice 99-1 also do not address or apply to the use of electronic technologies with respect to participant loans, notices to interested parties (in connection with an application for a determination letter), notices under ERISA § 204(h), and notices associated with the § 401(k) and 401(m) safe harbors. Moreover, because Notice 99-1 is limited to Code § 401(a) and 401(k) plans, it does not apply to or provide guidance on the application of new technologies in the administration of section 457 and 403(b) plans.

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DOL Proposed Regulations

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The existing regulations provide a safe harbor on which group health plans may rely in furnishing SPDs and summaries of material modifications ("SMMs") through electronic means. The rules that were proposed last January expand the safe harbor to all pension and welfare benefit plans covered by ERISA and to summary annual reports ("SARs"). The new proposed rules also establish standards for the maintenance and retention of plan records required by ERISA and 107 and 209 in electronic form.

Proposed safe harbor. To fall within the proposed safe harbor, the plan administrator must take "appropriate and necessary measures to ensure that the system for furnishing documents results in actual receipt by participants of transmitted information and documents (e.g., uses [a] return-receipt electronic mail feature or conducts periodic reviews or surveys to confirm receipt of transmitted information)." The electronically delivered documents must be prepared and furnished in a manner consistent with the generally applicable style, format, and content requirements under ERISA. In addition, each participant must be notified (either electronically or in writing) of the documents to be furnished electronically, the significance of the documents,

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Other Disclosure Obligations. The proposed rules do not extend the safe harbor to ERISA § 104(b)(2) (making certain plan materials available for examination by plan participants and beneficiaries) and ERISA § 104(b)(4) (responding to requests by participants and beneficiaries for copies of certain plan materials).

The proposed rules also do not address other potential uses of electronic media, such as the electronic delivery of individual benefit statements, COBRA notices upon a "qualifying event," or notices concerning qualified domestic relations orders or qualified medical child support orders. Other examples of issues not addressed include the electronic administration of plan loans and electronic payroll deduction agreements, or whether ERISA § 404(c) permits participants to give investment instructions and to receive information on investment alternatives by electronic transmission.

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Generally, the recordkeeping system must have reasonable controls to ensure the integrity, accuracy, authenticity, and reliability of the records kept. The records must be maintained in reasonable order, in a safe and accessible place, and in such manner that they may be readily inspected or examined. The records must also be legible and readable when displayed on a video terminal and be capable of being readily converted into legible and readable paper copy. Moreover, adequate records management practices must be established and implemented. In addition, the electronic recordkeeping system must not be subject to any agreement or restriction that would limit a person's ability to comply with ERISA requirements.

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It should be noted that the DOL is of the view that the proposed standards are not inconsistent with guidance issued by the IRS (i.e., Rev. Procs. 98-25 and 97-22, which are discussed above) regarding the maintenance of records on an electronic storage system.

What Should Plan Sponsors Do?

Both sets of proposed regulations facilitate the use of new technologies in plan administration. The IRS' proposed regulations are proposed to be effective the first day of the first plan year beginning on or after the date that is six months after they are published as final regulations. The DOL's proposed regulations will be effective no earlier than the same date (determined with respect to final DOL regulations). In the interim, the preamble to the IRS' proposed regulations state that plan sponsors and administrators may rely on the proposed regulations. Pending final regulations, the Department of Labor has indicated that "good faith compliance with the standards set forth in [its] proposed regulations will . . . constitute compliance with a reasonable interpretation of [its regulations] and ERISA sections 107 and 209."

Plan sponsors and administrators who are already using the new technologies in plan administration should check their practices against the recent regulatory guidance, while those who are not using the new technologies may wish to consider doing so.

It is also very important that plan sponsors and administrators relying on the proposed regulations ensure that their plan documents are consistent with the use of new technologies. If plan operation is not consistent with the plan document with respect to the form and timing of notices and consents, this is a violation of the qualification requirements under the Code. Accordingly, timely plan amendments may be needed to reflect any changes in operation to reflect the new guidance. In this regard, plan sponsors may wish to consider providing themselves with flexibility in their plan documents, so that they can adjust to any future changes in the law or in operation without further plan amendments. For example, a plan sponsor may wish to consider providing in its plan documents that all notice and consent requirements -- including those not addressed by

the proposed regulations or Notice 99-1 -- may be satisfied in any manner permitted under the law.

