INVESTMENT COMPANY INSTITUTE®

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February 3, 2021

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2020-80)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Protection of Annuity and Spousal Rights Under ERISA Section 205 with Respect to a Terminating 403(b) Plan Funded Through Custodial Accounts (Notice 2020-80)

Dear Sir or Madam:

The Investment Company Institute[1] is pleased to respond to the request for comments in Notice 2020-80, regarding the application of the annuity and spousal rights provisions of section 205 of the Employee Retirement Income Security Act of 1974 (ERISA). More specifically, Notice 2020-80 focuses on the application of ERISA section 205 in connection with a distribution of an individual custodial account (ICA) in kind from a terminating section 403(b) plan.

As explained in greater detail below, where ERISA section 205 protections apply to a 403(b) plan funded through custodial accounts, practical realities will often necessitate that applicable consent

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$28.5 trillion in the United States, serving more than 100 million US shareholders, and US$8.3 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

requirements be satisfied[2] with the involvement of the plan administrator before the plan termination is completed and the plan no longer exists.

Background

Section 110 of the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act)[3] directs the Secretary of the Treasury to issue guidance providing that, if an employer terminates the plan under which amounts are contributed to a section 403(b)(7) custodial account, the plan administrator or custodian may distribute an ICA in kind to a participant or beneficiary of the plan and the distributed custodial account shall be maintained by the custodian on a tax-deferred basis as a section 403(b)(7) custodial account, similar to the treatment of fully-paid individual annuity contracts under Revenue Ruling 2011–7, until amounts are actually paid to the participant or beneficiary.[4]

To implement this direction, the Internal Revenue Service (IRS) and Treasury Department (Treasury) issued Revenue Ruling 2020-23 (Ruling), specifically addressing whether a non-ERISA 403(b) plan that is funded through the use of section 403(b)(7) custodial accounts and that takes certain specified actions to distribute the assets of the plan, has been terminated in accordance with the rules of Treasury Regulation section 1.403(b)-10(a), and whether distributions made to participants or beneficiaries in connection with termination of the plan are includible in gross income. Section 403(b) plans that are not covered by ERISA are not subject to the annuity and spousal rights protections found in ERISA section 205, and no section 403(b) plans are subject to the parallel annuity and spousal rights provisions of sections 401(a)(11) and 417 of the Internal Revenue Code. The Ruling, therefore, does not address how to apply annuity rights and spousal protections in a terminating 403(b) plan funded through custodial accounts.

In conjunction with Revenue Ruling 2020-23, the IRS issued Notice 2020-80, asking for comments on these issues.[5] The Notice explains that issues remain regarding the application of section 205 of ERISA in connection with a distribution of an ICA in kind for a 403(b) plan with at least one participant to

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[2] Our letter does not address other approaches to dealing with the applicability of section 205 protections, such as amending the terminating plan prior to distribution to eliminate annuity forms of distribution. For purposes of our comments, we assume that the plan and custodian have determined that annuity and spousal rights apply in connection with the in-kind distribution.

[3] The SECURE Act was enacted on December 20, 2019 as part of the Further Consolidated Appropriations Act of 2020.

[4] Section 110 further instructs that the guidance shall provide (i) that the section 403(b)(7) status of the distributed custodial account is generally maintained if the custodial account thereafter adheres to the requirements of section 403(b) that are in effect at the time of the distribution of the account and (ii) that a custodial account would not be considered distributed to the participant or beneficiary if the employer has any material retained rights under the account (but the employer would not be treated as retaining material rights simply because the custodial account was originally opened under a group contract). Finally, Section 110 provides that the guidance shall be retroactively effective for taxable years beginning after December 31, 2008.

[5] The IRS has interpretive authority over section 205 of ERISA pursuant to the Reorganization Plan No. 4 of 1978, 5 U.S.C. App.

whom section 205 of ERISA applies,[6] including if (i) a participant cannot be reached, (ii) a participant does not elect to waive the QJSA and QPSA form of benefit, or (iii) a married participant elects to waive the QJSA and QPSA form of benefit but the participant's spouse does not consent to the waiver. Among other things, the Notice asks for "[v]iews regarding the administrability of alternative dates . . . for when rights under section 205 of ERISA might be required to be protected, for example, at the time of the termination of a [section] 403(b) plan (by obtaining the participant's waiver and the spouse's consent, pursuant to section 205(c) of ERISA, to a distribution in kind of an ICA), or at the time payments are made from the ICA (analogous to [Treasury Regulation section] 1.401(a)-20, Q&A-2, which provides that the requirements of [Code sections] 401(a)(11) and 417 . . . are applied to payments under distributed annuity contracts."

Applicable Annuity and Spousal Rights Should be Permitted to be Protected at the Time of Plan Termination

This letter reiterates points we made in a letter to Treasury dated May 18, 2020[7] relating to the in-kind distribution of custodial accounts upon termination of a 403(b) plan, as contemplated by section 110 of the SECURE Act. In that letter, we requested clarification of the implications for distributed ICAs where the terminated plan may be subject to QJSA and QPSA requirements, such as might be the case where the plan offered annuity distribution options through some (but not all) vendors.[8] It is important that any annuity rights and required consent to waive rights under ERISA section 205 be permitted to be satisfied at the time of the plan termination (i.e., when the in-kind distribution occurs).

The assets of a custodial account must be held by a bank or an approved non-bank trustee or custodian.[9] Section 403(b)(7) custodial accounts do not hold annuities as investments. Annuitization of amounts held in a 403(b) custodial account can be accomplished only through the purchase by the plan of an annuity contract on behalf of the participant, which annuity contract may be selected by the plan administrator or participant – but typically not the custodian – and issued either to the plan sponsor or participant.

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[6] Section 205 of ERISA generally requires distributions in the form of either a qualified joint and survivor annuity (QJSA) or a qualified preretirement survivor annuity (QPSA), unless the plan is not a defined benefit plan or money purchase pension plan and under the plan: (i) a full death benefit is provided to the surviving spouse, (ii) no participant election of a distribution in the form of a life annuity is made (and a life annuity is not the normal form of benefit), and (iii) no part of the distribution is the result of a transfer from a defined benefit plan or a money purchase pension plan. Section 205(c) of ERISA provides that a participant may elect to waive the QJSA or QPSA form of benefit, but spousal consent is needed for a waiver by a married participant.

[7] See Letter to William Evans, Attorney-Advisor, Office of Benefits Tax Counsel, U.S. Department of the Treasury, dated May 18, 2020, from the Investment Company Institute and the American Retirement Association.

[8] For purposes of this letter, we assume a determination has been made that QJSA and QPSA requirements apply with respect to the plan and we take no position on the circumstances in which such requirements are correctly determined to apply.

[9] Internal Revenue Code section 401(f)(2); Treasury Regulation section 1.403(b)-8(d)(2).

In order to terminate a retirement plan, all assets of the plan must be distributed as soon as administratively practicable.[10] Assets distributed from an ERISA-covered plan generally are no longer considered plan assets subject to ERISA. After the plan termination process is completed, the plan legally ceases to exist and the distributed assets are no longer part of a plan that is subject to ERISA. Furthermore, after plan termination, there is no "Plan Administrator" as defined in ERISA[11] to fulfill the administrative responsibilities connected with ERISA section 205. Those responsibilities include ensuring that plan terms reflect the requirements of ERISA section 205; providing required notices; collecting the required participant elections and spousal consents; and selecting and purchasing an annuity on behalf of the participant.

Therefore, as a practical matter, where ERISA section 205 protections apply to a plan funded through custodial accounts, the annuity rights and spousal consent requirements would be best satisfied with the involvement of the plan administrator before the plan completes termination and no longer exists.[12] Any notion that the QJSA and QPSA requirements must be incorporated into the terms of the distributed ICAs would be unworkable for many custodial account providers.

We acknowledge that in situations where annuity and spousal rights apply, the ability to unilaterally distribute a 403(b) custodial account in kind may be impeded.[13] The approach of forcing an in-kind distribution of an ICA is particularly useful when the 403(b) plan participant is missing or otherwise non-responsive to communications about the plan's termination. Having to obtain consent at the time of the in-kind distribution could therefore prevent use of this approach in these limited situations. However, the in-kind distribution approach contemplated by the SECURE Act still has some utility where ERISA section 205 applies, because a participant may be willing to affirmatively consent to the in-kind distribution (and obtain the spouse's consent), but may be unwilling to consent to another type of distribution from their custodial account (such as a cash distribution or rollover distribution). For this reason, it would be helpful for the IRS to provide an example, otherwise similar to the examples provided in Revenue Ruling 2020-23, of a plan termination involving in-kind distribution of a custodial account to a participant upon affirmative consent.[14]

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[10] See, e.g., Revenue Ruling 2011-7.

[11] 29 C.F.R. § 2510.3-16(a) ("The term 'plan administrator' or 'administrator' means the person specifically so designated by the terms of the instrument under which the plan is operated. If an administrator is not so designated, the plan administrator is the plan sponsor, as defined in section 3(16)(B) of ERISA.")

[12] We note that nothing should prohibit the custodian of a distributed ICA from applying the spousal consent requirements later upon a distribution from the ICA, where such course of action is contemplated by an agreement between the custodian and the plan. Under this approach, if consent is not obtained at that later point in time, the proceeds presumably would need to be transferred to a distributed annuity contract, in order to provide the life-contingent distribution.

[13] As noted earlier, there may be other methods of addressing section 205 rights in a terminating 403(b) plan. We do not opine on the appropriateness of a plan sponsor's determination in this regard.

[14] The factual situations described in Revenue Ruling 2020-23 involve in-kind distribution of ICAs without an election by the participant.

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We appreciate the opportunity to provide our input as you work to implement section 110 of the SECURE Act. If we can provide you with any additional information regarding these issues, please contact Elena Chism at 202/326-5821 (elena.chism@ici.org).

Sincerely,

/s/ Elena Barone Chism

Elena Barone Chism
Associate General Counsel – Retirement Policy