INDIVIDUAL RETIREMENT ACCOUNT ("IRA") ROLLOVERS

<u>Lump Sum Distribution Options</u>

Defined benefit plans (commonly referred to as "pension plans") traditionally paid benefits in annuity form over a participant's life (or over the joint lives of the participant and his or her spouse). Such annuity payments may not be rolled over. The amount received is reported as income in the year of receipt and income taxes are paid on this amount.

Participants in defined contribution plans (such as profit sharing plans and 401(k) plans), and an increasing number of defined benefit plans, however, have the option of taking a lump sum distribution on termination of employment, at any age. A participant who receives a lump sum distribution generally has 4 alternatives to consider, as follows:

1. **Leave the money in the former employer's plan.** Many employers do not want the trouble and expense of maintaining accounts for former employees and discourage use of this alternative, such as by limiting investment choices, restricting the availability of future distributions or charging higher fees than to current employees.

2. **Transfer the funds to a new employer's plan.** Nevertheless, some plans do not accept rollovers or make rollovers difficult because of concerns that accepting a rollover from a plan that is not fully in compliance with the Internal Revenue Code of 1986, as amended ("Code"), mat taint their plans.

3. **Transfer the funds, directly or indirectly, to the participant's IRA.** A direct rollover is generally preferable as it avoids the 20% mandatory income tax withholding that would otherwise apply,

4. Keep the money and pay income tax on the amount distributed in the year of receipt plus, in most cases where the participant is under age 59-1/2, a 10% additional income tax.

<u>**Advantages and Disadvantages of Rollovers**</u>

An IRA rollover has several ***advantages***. It severs the tie with the former employer, gives the participant the greatest degree of control, offers a wider variety of investment choices and makes it possible for the person to take irregular distributions or to stretch out distributions to the greatest extent allowed by the age 70-1/2 required minimum distribution rules.

An IRA rollover, however, also has significant ***disadvantages***, which are not often fully understood or examined by the participant. First, the participant is now responsible for the successful long-term investment of the funds, generally with no review of available options by a fiduciary.

Second, the participant must avoid engaging in any prohibited transaction with the IRA and its funds, as that would trigger immediate income taxation of the entire account. Figuring out how the complicated prohibited transaction rules apply to IRAs is very difficult, and many IRA owners can't resist the allure of exotic investment vehicles pitched to them by promoters that might in some manner violate these rules.

Third, the individual no longer has the benefit of the ERISA fiduciary responsibility rules. Most cases have held that the duties of an investment custodian are limited to those it accepted in its contract with the IRA owner, a contract almost always drafted by and in favor of the custodian. Attempts by the Department of Labor and the Securities and Exchange Commission to extend fiduciary rules to IRAs and broker-dealers are controversial and are presently stalled.

Fourth, employer plans offer lower fees, typically provide more transparent fee disclosures and give better access to advice.

Conclusions

A decision to make an IRA rollover should not be made lightly, casually or unadvisedly. The decision has important ramifications for the individual's future financial security. Even a modest rollover by a young individual may have an enormous impact when he or she retires.

Plan fiduciaries should consider taking steps to explain better the options available to a participant taking a distribution and to monitor the types and sources of advice he or she receives regarding the distribution. Such precautions may help the participant make a better decision and may also protect the fiduciary against claims that it failed to satisfy its ERISA responsibilities.