

## **Final 403(b) Regulations**

### **General Questions & Answers**

#### **1. What is the general purpose or intent of these Final 403(b) Regulations and what is the impact on my 403(b) Plan?**

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The intent of the regulations is (a) to bring 403(b) plans more into line with other types of employer sponsored qualified retirement plans such as pension and 401(k) plans; and (b) to address specific compliance concerns revealed in the extensive IRS audit program that took place prior to the issuance of the Final Regulations. In the eyes of the IRS, 403(b) plans are clearly to be considered “employer accountable plans”.

This will be a significant change for those of you who operate purely voluntary, reasonable choice, non-ERISA plans (with no employer contributions) where you essentially provide only the opportunity for employees to enroll and the payroll function that facilitates their “elective deferrals”. If you are not careful, you will have added responsibilities that could subject your group to certain ERISA provisions.

Those of you who currently operate your voluntary plans in compliance with ERISA and/or have employer contributions are still impacted, but to what degree will depend on the structure of your 403(b) plan.

#### **2. What is/are the effective date(s) of the Final 403(b) Regulations?**

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For most of the new provisions, the effective date is Tax Years beginning after 12/31/2008, i.e. January 1, 2009. However, as explained below, some provisions have different effective dates. You can rely on the Final Regulations now, but if you do so, you must operate your 403(b) plan in accordance with all of the new requirements.

#### **3. Is there anything I must do or be aware of right now?**

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Yes!:

- a. You must understand the new rules regarding *Contract Exchanges, Plan Transfers, and Rollovers*.
- b. You must make sure that you comply with the *Universal Availability* rule and the redefined classes of excludable employees.
- c. If you are thinking about eliminating your 403(b) plan altogether, then the new *Plan Termination* rules may be of use to you.
- d. Your plan must be “in writing” as of 01/01/09 – more on this new “*Plan Document*” requirement below.

#### 4. What are the new rules for moving money between contracts and other 403(b) plans?

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Currently, *transfers* between vendor contracts are known as 90-24 exchanges or transfers and may occur **without employer approval or involvement** (the participant is free to transfer their voluntary 403(b) account to any vendor they wish).

However, the Final Regulations do away with 90-24 exchanges or transfers after September 24, 2007. After that date, in practical terms, you as the plan sponsor must declare or identify the vendors whose contracts will be eligible for investment under your 403(b) plan, and only money movements between these “approved vendors” will be allowed. Think of this as a transfer within the choices offered by 403(b) plan of the employer. The new term is “**Contract Exchanges**” *(between approved contracts and accounts within the 403(b) plan)*.

More importantly, you will be responsible for the new rules and provisions these Contract Exchanges must follow, which generally require the new contract or account to follow the same stringent distribution restrictions as the old one and that there be no loss of benefits to the employee. While you are not required to even allow contract exchanges, if you do, then these provisions (and a listing of the approved vendors) must be in your written plan as of 1/1/09, otherwise any contract exchanges that take place between September 25, 2007 and January 1, 2009 might become taxable to the employee retroactively (i.e. no tax-free exchange).

Contract Exchanges must satisfy the following requirements:

- a. The Plan must approve the exchange.
- b. The accumulated benefit cannot decrease (but the “accumulated benefit” is the amount in the contract after any surrender charges are applied). There can be no other costs assessed to the participant for the transaction.
- c. The new contract/account must contain at least the same distribution restrictions as the old.
- d. An **Information Sharing Agreement (ISA)** is required between you and the vendors containing:
  1. The participant’s employment information.
  2. Any other contracts owned by the participant.
  3. Any outstanding hardship distribution or loan information.
  4. Any other needed compliance information.

The new term “**Transfer**” will apply only to a plan to plan movement of monies. In simple terms – Contract Exchanges occur within one plan – Transfers are between different plans.

The new rules for Transfers are:

- a. The participant must be an employee, former employee, or beneficiary of the receiving plan.
- b. Both plans must provide for transfers as part of their written plan.
- c. The “accumulated benefit” cannot be less in the receiving plan.
- d. At least the same distribution restrictions must apply after as before.
- e. Pro rata rule for partial transfers
- f. An “Information Sharing Agreement “ will be required.
- g. Only a transfer to another 403(b) plan will be allowed.

While we're on the topic, the “**Eligible Distribution/Rollover**” rules modified by the Pension Protection Act are not affected by the Final 403(b) Regulations. These rules allow former participants with a distributable event to move monies to a variety of plan types under an entirely different set of rules.

## **5. What is an Information Sharing Agreement (ISA) and what if I want to have someone else handle ISA's on my behalf?**

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Under the final regulations, you, as plan sponsor, become responsible for seeing that new operational rules are followed. If you fail to do so, your entire 403(b) plan, including all participant accounts, may be “disqualified”, and thus taxable. You will need to make sure the vendors you have in your 403(b) plan will agree to comply and share information between themselves. **Most importantly, you will have to supply employment and payroll information with the vendors you approve for your plan.** You must clearly understand...and act on this...to avoid severe penalties to the participants. You must have separate ISA's with each product vendor you use.

Many product vendors are incapable or unwilling to comply with the new ISA rules and will leave the 403(b) plan arena. Consider consolidating your various vendors/providers with a central record keeper who will enter into ISA's on your behalf. But remember, the requirement to share information with the central record keeper still ultimately rests with you and you will need an ISA with that entity too. Gardner & White, as a broker of 403(b) plans, has made arrangements with one of its Preferred Business Partners to offer this service to you.

## **6. What does “Universal Availability” mean and what classes of employees could I choose to exclude from my 403(b) plan?**

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The Final 403(b) Regulations change which classes of employees may be excluded from a 403(b) plan and still meet the Universal Availability requirement (essentially the requirement says that if one employee from an eligible employee group is eligible, then all members of the group must be eligible). Under the new rules you can, on an optional basis, exclude the following employee classes:

- a. Non-resident aliens.
- b. Employees eligible for 457(b) deferrals (governmentals only).
- c. Students, and
- d. Employees who normally work fewer than 20 hours per week (1,000 hours a year looking back and looking forward—this is new).

There is a phase out and elimination of additional classes listed in IRS Notice 89-23. The Final Regulations eliminate them after 2010 for most employers:

- a. Employees covered by a collective bargaining agreement.
- b. Certain visiting professors.
- c. Employees of a religious order who have taken a vow of poverty.
- d. Employees who make a one time election to participate in a governmental plan instead of a 403(b).

Note that new employees must be eligible if it is reasonable to assume they will work at least 20 hours a week – looking forward. After one year of employment (on a looking-back basis), if the employee actually worked at least 1,000 hours in the previous year (and the employee is in an eligible group), then that employee is also eligible.

Make sure that you include all eligible employees in your 403(b) plan (one of the most common violations the IRS found). You must provide a “meaningful” written notice at least annually, and that all eligibles have a “reasonable opportunity” to participate in your 403(b) plan. Violations can result in a total plan failure.

For ERISA complying plans, you must also follow the ERISA eligibility and fiduciary liability rules. If your plan has adopted Section 404(c) fiduciary liability protection, you must also comply with those unique requirements.

## **7. Must I now have a written Plan Document and how formal does it have to be? Will this automatically make my plan subject to ERISA? What does a “written plan” mean?**

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The new Regulations require that your plan be “in writing” in order to satisfy the 403(b) rules and regulations in form and operation. This does not mean a formal Plan Document per se, but rather that general provisions of how you will operate the plan must be in writing. Items to be included are:

- a. Eligibility
- b. Benefits
- c. Applicable Limitations
- d. Contracts available or eligible under the plan
- e. Time and form of distributions
- f. Roles and responsibilities under the plan

Note that while the items above must be included in your plan, the following items are optional:

- a. Employer contributions
- b. Roth contributions
- c. Hardship withdrawal provisions
- d. Loans
- e. Acceptance of rollovers
- f. In service withdrawals
- g. “Contract Exchanges” to 403(b) products approved within the plan
- h. Plan to plan transfers (in or out)

The written plan may refer to and/or include related documents such as state statutes and regulations, administrative procedures, lists of authorized providers and products, required forms, vendor contracts, and service agreements. In general terms, the new Regulations contemplate a central documents and record keeper.

The Department of Labor issued companion guidance in the form of a Field Assistance Bulletin No.2007-02 on July 24, 2007 describing “safe harbor” guidance on how a currently non-ERISA plan can comply with the new regulations and still remain non-ERISA. Merely complying with the Final 403(b) Regulations including the “written plan” requirement does not make a 403(b) plan subject to ERISA per se.

## 8. Where can I get help in satisfying my written plan obligation and/or obtain an approved written plan sample?

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The vendor community is already in the process of preparing these materials for plan sponsor use. The IRS has indicated it will have a Sample Written Plan appropriate for public school systems before the end of 2007. Some vendors have already indicated they will prepare the documentation and amendments as necessary for their customers.

Most importantly...Gardner & White, as a broker of many different vendors' 403(b) plan products, will see that you have everything you will need to be in compliance, regardless of the vendor(s) you choose and/or the type of 403(b) plan you will be operating.

**Warning:** Make sure that whoever agrees to provide you with a "written plan document" will also agree to maintain it going forward.

## 9. What if I just want to terminate my 403(b) plan altogether?

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The Final 403(b) Regulations provide an optional mechanism to allow you to terminate your 403(b) plan. Maybe! Previously, there had been no way for a plan sponsor to terminate a 403(b) plan. At best, plan sponsors could freeze a plan and stop contributions, but not "close" the plan and move the assets. Now that you will become responsible for the operation of your 403(b) plan, and must see to it that all administrative processes are satisfied, you may wish to terminate and close your 403(b). Note this applies to the entire plan, which includes all vendor offerings in which you currently or previously allowed your employees to participate. There is no provision for a partial termination of a 403(b) plan on a contract-by-contract basis.

Please note that all assets in all contracts/accounts in your plan must be terminated by you. There is a very serious problem here because there are many types of 403(b) insurance contracts and custodial accounts that are issued directly to the participants, and not to you as the employer/plan sponsor, so you do not actually hold or control these contracts. There are still questions about "exactly how do I do this" but there is guidance in the regulations on what must be done:

- a. Your plan must be amended to permit a plan termination (remember that all 403(b) plans now must be in writing).
- b. ALL accumulated benefits, in all vendor contracts (both employee and employer), must be distributed to participants as soon as practicable.
- c. You can't make contributions to an "alternate" 403(b) plan within the next 12 months.
- d. The distribution to employees can be in the form of cash, or a rollover to another 403(b) plan, a 401(k) plan, or a personal IRA.

## 10. With all these new requirements, why don't I just cancel or close my 403(b) plan and go with a 401k plan?

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There are several advantages to the 403(b) platform for your retirement plan, whether you use 403(b) as your primary retirement plan or as a supplemental voluntary program focused on helping employees leverage the advantages of pre tax deposits and tax deferred growth. Briefly they are:

- a. No ADP testing for elective deferrals
- b. No Top Heavy Testing for elective deferrals
- c. No IRS Favorable Determination Letter (FDL) requirement
- d. Multiple 415 contribution limits for most employees
- e. Special 15 years of service catch up for many non-profit employees
- f. No ERISA fiduciary obligations for non-ERISA plans
- g. No 5500 or Summary Plan Description for non-ERISA plans
- h. No annual outside audit for non-ERISA plans (big expense item)
- i. No bonding requirement for non-ERISA plans

Please see our Summary Table comparing 401k to 403(b) plans. You will see that 403(b) continues to offer the plan sponsor and participants many significant advantages.

### **11. I just offer a purely voluntary 403(b) plan with multiple vendors (reasonable choice and not ERISA complying, with no Employer Contributions) for my participants to choose from. What will the new regulations mean to me?**

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There has been some fear mongering in the benefits media, and many advisors and consultants are suggesting that offering more than one 403(b) vendor under the new regulations isn't practical or advisable. This clearly is not the case. As a plan sponsor, you will need to sort through two issues:

- a. *What are my new responsibilities, which ones should I accept, and which ones should I avoid in order to prevent my plan from becoming subject to ERISA?*

At a minimum, you must comply with the following:

1. Make certain maximum annual contributions are not exceeded, including the personal Section 402(g) limit, the age 50 catch up limit, and the special 15 year with same employer catch up.
2. Perform Discrimination testing in plans requiring it.
3. Ensure participants have a "reasonable choice" of contracts or accounts, and investment options.
4. Confirm that the plan operates in accordance with the regulations with respect to distributions including loans, hardship amounts, and IRC Section 415 excess contributions (a separate account must be maintained if not returned).
5. Provide universal availability and satisfy other compliance items

There are several items you cannot do, because if you do, your plan will subject to Title I or ERISA:

1. Approve plan to plan transfers.
2. Approve distributions.
3. Satisfy the qualified joint and survivor annuity requirements.
4. Make hardship distribution determinations.
5. Determine the validity of QDROs - qualified domestic relations orders.
6. Determine the eligibility or enforcement of participant loans.

- b. *OK, I don't want my plan to fall under the ERISA provisions, and I am worried about managing the list of "do's and don'ts". What else can I do... and can I hire someone else to help?*

One thing you can do is streamline your 403(b) vendor offerings – the fewer vendors you have the fewer you have to monitor, keeping in mind that you are still required to offer reasonable choices of investment options for your employees (which is still not defined under ERISA) and provide information sharing.

What many plan sponsors in this situation will do is hire an independent third party administrator to handle the plan for them. Gardner & White is prepared to help you locate and contract with firms who will be providing 403(b) plan administration support.

## **12. Aren't there some employer groups exempt from ERISA by law?**

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Yes!

- a. Plans of governmental employers
- b. K-12 public schools
- c. Community colleges
- d. Public universities
- e. Some charter schools
- f. County hospitals
- g. Church plans that do not elect to be covered by ERISA

## **13. What are the new “catch up” ordering rules and how do they work?**

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The Final 403(b) Regulations stipulate that all catch up contributions (including those that were originally made under the “age 50 catch up provision”) are first attributed to the special 15 year catch up which is available to these specific employer types:

- a. Education related
- b. Church related
- c. 414(e) religious groups
- d. Hospitals
- e. Home health services
- f. “Health and welfare” agencies - newly defined as medical care, prevention of cruelty to animals/children, adoption agencies, and agencies that provide substantial services to the needy

Catch up contributions falling under the Special 15 year catch up are then followed by any contributions attributed to the age 50 catch up provisions.

## **14. What else do I need to know about the Final 403(b) Regulations.?**

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There are several other provisions contained in the new regulations, specific to certain types of plans and situations. We mention some briefly below. If they apply to your plan, please contact your local Gardner & White representative or call your Gardner & White Service Quality Manager in Indianapolis.

- a. New definitions of “employer” for organizations under common control (if 80% of the directors/trustees are common to more than one employer they are considered one employer for 403(b) provisions (common control for governmental employers is based on the payroll source).

- b. Life insurance contracts are no longer an eligible funding source.
- c. A job move from a 403(b) eligible employer to a for profit employer in the same control group will be considered a separation from service for purposes of satisfying the “distributable event” rules under 403(b).
- d. Post employment employer contributions cannot be made after the participant’s death (there is still confusion as to exactly when contributions must cease) unless there is a specific provision for post death contributions.
- e. Elective deferrals must be transmitted to the vendor within 15 days after the month in which the pay is made (but more stringent rules apply to ERISA-complying 403(b) plans).
- f. “Hardship Withdrawals” from 403(b) plans will follow the 401(k) rules.

**15. OK – I’m still really confused. If I do not have my” written plan” done, for example until January 1, 2009, how can I comply with all of these new rules?**

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The Final 403(b) Regulations say you may “operate” your plan with respect to changes as if your written plan and/or documentation were in place. You can not pick and choose which of the new rules you will have to comply with if you become an “early adopter”. The most immediate issue is how to handle Contract Exchanges prior to 2009 (see discussion above)--you may have a “black hole” during which you must comply with the new provisions without actually having them in writing.

**Commentary:**

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There are many pitfalls waiting for the unwary 403(b) plan sponsor. As one reviewer wrote, “it will be much harder for 403(b) plans of Section 501(c)(3) organizations to avoid ERISA”, despite the DOL Field Assistance Bulletin outlining the safe harbor provisions designed to do otherwise.

The vendor/provider community has a huge job ahead of them. All of us in the 403(b) community; you as plan sponsors, we as consultants and brokers, are looking for answers as well as materials to meet the requirements of the new regulations. That many vendors will withdraw from the 403(b) market is a given. That those remaining will adjust their costs is anticipated.

Clearly, one size doesn’t fit all regarding what to do about these regulations. We feel that for those of you whose plans currently comply with ERISA, the impact will be somewhat limited. The advantages of 403(b) over 401(k) are meaningful and significant. Given the choice, most eligible employers would rather have a 403(b) plan, maybe even one subject to ERISA, than a 401(k) plan.

For those of you with non-ERISA, purely voluntary plans, this will be somewhat of a culture shock, especially if you have never offered a qualified retirement plan to your employees. New rules, forms, and procedures; and no longer can you simply call your representative or insurance company and say “Handle this for me please, I just remit contributions for my employees”.

Will the newly mandated involvement on your part be worth the advantages to you and your participants? The answer is still “yes”. The alternatives aren’t any better, and most are worse. In an age where people need more for retirement than ever, and save less, 403(b) will continue to play a major role, albeit a more accountable one.

*UPDATED: 08/30/07*