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§403(b) To Do List: Getting Ready for 2009

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Background

Despite the best efforts of many industry practitioners to delay the effective date, all indications are that the final IRS §403(b) regulations will become effective January 1, 2009. There is much that needs to be done before that date to comply with the new regulations.

Before January 1, 2009, employers should:

- Adopt a written plan that meets the requirements of the final regulations
- Identify the vendors that are approved to receive future contributions
- Allocate responsibility for administrative tasks with approved vendors
- Notify non-approved vendors
- Make sure the plan is available to all eligible employees
- Carefully review any proposed plan termination
- Determine if the plan is subject to ERISA

Plan Document

The final regulations require 403(b) plans (both ERISA and non-ERISA) to be maintained in accordance with a written plan document that complies with the new regulations and specifies the terms and conditions for eligibility, contribution limitations, and benefits under the Plan. The written plan may be a stand-alone document or it may consist of a collection of contracts and custodial agreements, but all plan terms must be in writing. Because there is no remedial amendment period for 403(b) plans (as there is for §401(a) plans) the written plan must be **formally adopted before January 1, 2009.**

A written plan is required for **all** §403(b) arrangements to which contributions were made at any time after December 31, 2004. The written plan requirement does not apply to non-ERISA plans that received no contributions after December 31, 2004.

Delayed effective dates apply to certain collectively bargained plans and church plans. If a §403(b) arrangement is maintained pursuant to a collectively bargained agreement in effect by July 26, 2007, then the final regulations will be effective on the date the bargaining agreement terminates or , if earlier, July 26, 2010. It is important to note that the delayed date does not apply merely because union employees participate in the §403(b) arrangement—the collective bargaining agreement must specifically require that the arrangement be maintained.

For church plans where the authority to amend the 403(b) plan is held by a church convention, the regulations are effective for the plan year beginning after December 31, 2009.

Vendor Selection

Practitioners can assist clients in determining which vendor(s) will be approved to receive contributions after 2008. Care should be taken to review in detail the willingness of each vendor to operate within the confines of the new plan design. Desired plan provisions, compliance requirements and a vendor's ability to assist in ensuring participant transactions should be reviewed with prospective vendors. A plan could also provide for no approved vendors, if the sponsor intends on freezing the plan.

Allocation of Administrative Responsibilities

For vendors that will continue receiving contributions, coordination will be necessary to determine how various plan provisions will be administered, including loans, hardship adjudication, monitoring of contribution suspension periods and distributions. Administratively, it may make sense to structure provider relationships to allow certain transactions from a single vendor only. For instance, limiting loan transactions to a single vendor should simplify compliance with IRC §72(p). The employer should have a written service agreement with each approved vendor. It is crucial for practitioners and employers to review and understand the terms of all agreements provided by vendors before signing.

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▲Non-Approved Vendors

There has been considerable confusion about "information sharing agreements" or "ISAs" with vendors. IRS spokespeople have made it clear that an ISA, as required by the new regulations, is required only in a situation in which the employer permits plan participants to transfer accumulated benefits from an approved vendor to a vendor that is not on the approved list. There is no general requirement that such an agreement be in place on January 1, 2009. However, contract exchanges made after 9/24/07 to providers with no ISA will require an executed ISA by January 1, 2009 or those contracts will need to be brought back into the plan (through a contract exchange with an approved service provider by July 1, 2009).

Vendors that are not approved to receive contributions after December 31, 2008, but who hold assets attributable to contributions made before that date, should be notified of the change and of the name and contact information for the person in charge of administering the employer's plan in order to coordinate information necessary to satisfy §403(b). Employers should advise vendors of their obligation to take appropriate action to exchange any necessary information with the employer prior to making any distribution or loan to participants or beneficiaries. This step should be well documented.

▲Universal Availability

With some exceptions, employees of an employer who maintains a 403(b) plan must be given the same opportunity to make elective deferrals and that opportunity must be "effective." Under the final regulations, effective opportunity requires that employees be given an annual notice of their right to defer, identifying the appropriate election period and any other conditions regarding elections.

The exceptions to the universal availability requirements are:

- Employees who would elect to defer less than $200 a year.
- Employees eligible to defer under another 403(b) plan, 401(k) plan or 457(b) eligible governmental plan of the employer.
- Non-resident aliens with no U.S. source income.
- Student employees performing services described in §3121(b)(10).
- Employees who normally work less than 20 hours per week, for the 12 month period beginning on the date of hire if the employer reasonably expects the employee to work fewer than 1000 hours of service and; for each determination year thereafter if the employee works less than 1000 hours of service in the preceding 12 month period.
- Church Plans.

Note that there is no general exception for collectively bargained employees, as there is for qualified plans.

▲Plan Termination

The final regulations permit the termination of a 403(b) plan, and a number of employers have considered doing so before January 1, 2009 to avoid the need to comply with the new regulations. However, actually accomplishing such a task may prove to be difficult if not impossible, given the nature of §403(b) contracts that exist today. The IRS requires complete distribution of assets within a "reasonable time" in order to carry out a plan termination. However, the employer is not a party to many existing annuity contracts and custodial agreements, and would not be able to force a distribution if the employee and the insurance company or mutual fund did not agree. In such a case, under current IRS policy, termination is impossible. Practitioners should exercise great caution in advising their clients about terminating a 403(b) plan.

▲ERISA

403(b) plans maintained by employers that are exempt from tax under §501(c)(3) of the Code are generally subject to ERISA unless they are exempt under a "safe harbor" that applies to deferral-only plans that are maintained with minimal employer involvement and discretion with respect to administrative decisions and investment options. Church plans are also exempt from ERISA, but may choose to be covered.

Because compliance with the new tax regulations requires employers to become more involved with the design and operation of 403(b) plans, programs that have previously been assumed to be non-ERISA should be reexamined in light of these changes. This is particularly important because, beginning with the 2009 plan year, 403(b) plans covered by ERISA are subject to extensive new reporting requirements, including (for plans covering 100 or more employees) filing of audited financial statements.