

403(b) Plans: IT'S A NEW WORLD

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Why Are We Here?

- ◆ First 403(b) regulations in over 40 years
- ◆ **Affect All 403(b) plans**
- ◆ Generally, plans must comply by 1-1-2009
- ◆ New 2009 DOL Form 5500 reporting regulations for ERISA 403(b) plans
 - Expanded Form 5500 reporting requirements
 - **Independent accountant plan audit requirements**

Why Should We Care?

- ◆ All employers are now responsible for their 403(b) plan, whether or not an ERISA plan

- ◆ Possible IRS and DOL sanctions
 - Non-compliance may lead to plan disqualification and immediate taxation of plan assets to participants
 - Penalties for missing or incomplete Form 5500 returns
 - ◆ DOL \$1,100 per day – no cap
 - ◆ IRS \$25 per day - \$15,000 cap

Agenda

- ◆ New Regulations Overview
- ◆ New Reporting and Audit Requirements
- ◆ Effects on ERISA and Non-ERISA 403(b) Plans
- ◆ Fiduciary Issues
- ◆ Next Steps
- ◆ Appendices
 - 403(b) Plan Overview
 - Why is Compliance Important?
 - Best Practices Issues and Considerations
 - 401(k)/ERISA/Non-ERISA 403(b) Plan Comparison



New Regulations Overview

In a Nutshell

- ◆ 403(b) plans will be treated like 401(k) plans
 - Employers are plan sponsors
 - Employers are responsible for plan administration
 - ◆ Employer can delegate administrative responsibilities
 - ◆ But not to participants
 - ◆ Employer **CANNOT** delegate liability

Significant Changes

- ◆ Written plan document required
- ◆ Stricter exchange and transfer rules
- ◆ Changed and clarified Universal Availability rules
- ◆ Must provide an annual notice to participants on rights to participate and methods for making or changing elections

Significant Changes

- ◆ Controlled group rule clarification
- ◆ Timing of deposit requirements
- ◆ Plan termination availability

Plan Document

- ◆ Must contain all material terms and conditions regarding:
 - Eligibility (Universal Availability)
 - Benefits / contributions
 - Applicable limitations
 - Contracts available
 - Time and form of distributions

Plan Document

◆ Optional provisions:

- Loans, hardship distributions
- Plan-to-plan or annuity contract transfers or exchange provisions
- Acceptance of rollovers
- Delegation of responsibility for administrative functions
- Can incorporate documents/agreements by reference

Plan Document

- ◆ Employer must sign document
- ◆ IRS Model plan document provisions for public schools can be used/modified
- ◆ Other documents available
- ◆ No IRS determination letter process, PLR can be done
- ◆ No remedial amendment period
- ◆ IRS approved prototypes will probably be available by 2012

Plan Exchanges

Effective 9/24/07:

- ◆ Open-ended contract-to-contract transfers effectively eliminated
 - Vendor must be listed in plan document; or
 - Vendor must have an Information Sharing Agreement with employer

- ◆ Exchanges within a plan:
 - Contract/plan must allow for the exchange
 - Accumulated benefit does not decrease
 - Exchanges allowed among the vendors receiving contributions under the plan, subject to the terms of Individual Agreements

Plan Exchanges

◆ What is an Information Sharing Agreement (“ISA”)?

- An agreement between an employer and a vendor to share information that facilitates proper plan administration, including:
 - ◆ Employment status
 - ◆ Contributions & Catch-ups
 - ◆ Distributions
 - ◆ Hardship withdrawals
 - ◆ Loans

Existing Plan Assets

- ◆ Discontinued/de-selected contracts (Rev. Proc 2007-71)
 - No contributions since 12/31/04 – grandfathered, no compliance responsibilities and not part of the plan
 - Contributions ceased 1/1/05 – 12/31/08 – reasonable good faith effort to include vendor contracts in current plan – notify vendor, but no response required
 - Pre-2009 contracts - vendor must make reasonable, good faith effort to contact employer before making any distribution or loan
 - Vendors are responsible for tax withholding

Plan Transfers

- ◆ 403(b) plan-to-403(b) plan transfers
 - Participant must be an employee (or former employee) of the employer for the recipient plan
 - Both plans allow for transfers
 - The participant's benefit must be the same amount immediately after the transfer
 - Transferee distribution restrictions no less stringent than transferor plan
 - Partial transfers need to include pro rata distribution of any employee after-tax contributions

Universal Availability

- ◆ Church Plans Exempt
- ◆ All employees of the employer must be permitted to make salary deferrals except:
 - Nonresident aliens
 - Employees eligible to make deferrals to another 403(b), 401(k) or 457(b) plan
 - Students under a work study program
 - Employees working less than 20 hours (expect less than 1,000 hours in the upcoming year and less than 1,000 hours in the preceding year)
- ◆ Cannot exclude collectively bargained employees

Universal Availability

- ◆ Notice requirement at least once a year for participants to have an effective opportunity to make (or change) a cash or deferred election
 - Stating the period of time during which an election may be made, and
 - Any other conditions on elections.

Universal Availability

- ◆ Applied separately to each 501(c)(3) common law entity
- ◆ Applied separately to each state entity not part of a common payroll
- ◆ May treat a geographically distinct unit as a separate organization for employee benefit purposes if the unit is operated independently on a day-to-day basis
 - Units are not geographically distinct if they are located within the same Standard Metropolitan Statistical Area

Controlled Group Rule Clarification for Tax-Exempt Entities

- ◆ Two or more Sec 501(c) organizations or the combination of a 501(c) org. and a non-501(c) org. under common control are treated as a single employer
- ◆ **Common control** means that the entities have a 80% or more common directorship, trusteeship or representation that is controlled directly or indirectly
 - Control means the general power to remove
 - Facts and circumstances determine

Controlled Group Rule Clarification for Tax-Exempt Entities

- ◆ The rules apply for purposes of:
 - Nondiscrimination requirements
 - 415 contribution limits
 - Special section 403(b) catch-up contributions
 - Minimum distribution rules

- ◆ Permissive aggregation of controlled group members now allowed

Timing of Deposit Requirements

- ◆ 403(b) elective deferrals must be transferred within a period that is not longer than is reasonable for the proper administration of the plan
- ◆ The plan may provide within a specified period after the date the amounts would otherwise have been paid to the participant
 - Within 15 business days following the month in which these amounts would otherwise have been paid to the participant
- ◆ ERISA Plans already subject to this rule
 - Typically within 7 days for most situations

Plan Freeze or Termination Availability

- ◆ Can amend plan to eliminate future contributions or to limit participation to existing participants and employees
- ◆ Can terminate the plan and allow accumulated benefits to be distributed on termination
 - The employer must not make contributions to any other 403(b) contract within 12 months after distribution of all assets from the terminated plan
 - < 2% employee rule

The New Audit Requirement

Financial statements and footnotes of large plans must be audited by an independent auditor

Current IRS/DOL Reporting

- ◆ Currently, there are minimal Form 5500 filing requirements for ERISA 403(b) plans
 - Form 5500, Part I and Part II, lines 1 through 5, and 8 (enter pension feature code 2L, 2M, or both)
 - Not required to
 - ◆ Engage an independent qualified public accountant and to attach an opinion to the Form 5500
 - ◆ Attach any schedules to the Form 5500
- ◆ For the 2009 year (due 2010) new Form 5500 rules will require same extensive reporting and independent audit requirements as apply to 401(k) plans.

New Reporting Requirements for ERISA 403(b) Plans - 2009 Plan Year

- ◆ Plan must file full Form 5500
 - Large plans – Financial info in Schedule H
 - Small plans – Financial info in Schedule I
- ◆ Financial statements and footnotes of large plans must be audited by an independent auditor
- ◆ All returns must be filed electronically
- ◆ Increased oversight

Form 5500 Preparation

Plan sponsors should be working with their service and investment providers **NOW** to be in compliance with the regulations on January 1, 2009.

Gather the necessary data **NOW**

New Reporting Requirements for ERISA 403(b) Plans - 2009 Plan Year

*“The DOL intends to fully enforce this
new audit requirement in 2009”*

403(b) Plan Audit Considerations

Will the Plan be auditable in 2009?

Careful consideration is essential in 2008 to ensure the Plan will be auditable in 2009

403(b) Plan Audit Considerations

- ◆ Statement of net assets must be comparative - 2009 and 2008
 - 2008 will be covered by auditor's report
 - ◆ 2008 information must be compiled, reviewed or audited
- ◆ Participant records may be difficult to "roll up" into plan level records
 - Auditor's cannot prepare your financial statements and then audit their own work!

403(b) Plan Audit Considerations

- ◆ Will the Plan qualify for limited scope audit?
 - Assets must be held by a bank, insurance company or trust company
 - Custodian must be willing to certify for limited scope audit

403(b) Plan Audit

- ◆ Information to be provided by plan sponsor to auditor:
 - Plan document (signed)
 - Plan amendments (signed)
 - Summary Plan Description
 - Copies of investment or insurance contracts
 - Vendor service agreements, including Information Sharing Agreements
 - Materials provided to new employees
 - All communication to employees regarding the Plan
 - All communication with DOL or IRS

403(b) Plan Audit

- ◆ Information to be provided by plan sponsor to auditor:
 - Listing of parties in interest
 - Meeting minutes
 - Legal correspondence
 - Year end statements for all plan assets (2009 and 2008)
 - Participant account statements (2009 and 2008)
 - Reconciliation of year end asset statements to participant account statements
 - Year end payroll or census report
 - Documentation that the payroll/census report is complete (reconciliation of compensation or participant counts to payroll)

403(b) Plan Audit

- ◆ Documentation of internal controls:
 - Entity level controls:
 - ◆ Who monitors the plan?
 - ◆ Are meetings held to discuss the plan?
 - ◆ Have there been any changes in key personnel or vendors involved with the plan?

403(b) Plan Audit

- ◆ Documentation of internal controls:
 - SAS 70 report for service providers (custodian, record keeper, etc)
 - Walk through each process with us
 - ◆ How earnings codes are set up in P/R system
 - ◆ How contributions are withheld from pay
 - ◆ How employer contributions are calculated
 - ◆ How contributions get to the plan
 - ◆ How are benefit payments requested by participant
 - ◆ How is new/terminated participant data remitted to the record keeper

403(b) Plan Audit

No controls?

Expect a SAS 112 – control deficiency letter from the auditor (every year until controls are put into place)

403(b) Plan Audit

- ◆ Information to be provided by plan sponsor to auditor:
 - Reconciliation of all contributions deducted from payroll to all contributions received into the plan
 - ◆ include pay dates and dates received into the plan
 - ◆ Late remittance of contributions?
 - Prohibited transaction

403(b) Plan Audit

- ◆ Information to be provided by plan sponsor to auditor:
 - Support for contributions receivable as of year end
 - ◆ Subsequent plan asset statements
 - ◆ Wire transfer confirmation

403(b) Plan Audit

- ◆ Information to be provided by plan sponsor to auditor:
 - Data files related to contribution deferral rate changes
 - Data files related to transmittal of hire and termination dates sent to the record keeper

403(b) Plan Audit

- ◆ Information to be provided by plan sponsor to auditor:
 - Nondiscrimination testing results (ER contributions only)
 - ◆ Listing of any excess contributions refunds
 - Subsequent plan asset statements

403(b) Plan Audit

- ◆ Information to be provided by plan sponsor to auditor:
 - Guaranteed investment contract or stable value funds:
 - ◆ SOP 94-4-1 information
 - Fair value
 - Contract value
 - Value of wrapper
 - Disclosures:
 - Nature of investment contract
 - How contract operates
 - Crediting interest rates
 - Methodology for calculating crediting interest rate
 - Average yield earned by the Plan
 - Description of events that limit the ability of the Plan to operate at contract value and whether those events are probable
 - Disclose circumstances that would permit issuers to terminate the contract

403(b) Plan Audit Considerations

- ◆ Information to be provided by plan sponsor to auditor:
 - Detailed listing of benefits paid out of the plan during the year
 - Detailed listing of all expenses paid by the plan during the year
 - Reconciliation of all transfers between the plan and other qualified plans

403(b) Plan Audit Considerations

...and all of the back up for any of those transactions the auditors choose to test

First year audit considerations

◆ Auditing beginning balances

- Auditor must apply sufficient auditing procedures on the beginning balance of net assets to obtain appropriate evidence that there are no material misstatements to these beginning balances that may affect the current year's statement of changes
- May have many years of operations

First year audit considerations

- ◆ Auditing beginning balances
 - Does the accumulation of opening participant account balances appear reasonable?
 - Have plan eligibility rules been followed?
 - Do contributions appear to have been made appropriately?
 - ◆ Payroll considerations
 - Significant rollovers in and out of the plan been in accordance with plan?
 - Do withdrawals appear to have been reasonable?
 - Investment activity appears reasonable?
- ◆ All of this to be considered over a potentially very long time period and/or large participant population



ERISA vs Non ERISA 403(b) Plans

ERISA 403(b) Plans

- ◆ Reporting and disclosure requirements
- ◆ ERISA fiduciary standards
- ◆ ERISA pre-empts state laws
- ◆ Not available to governmental employers

Non-ERISA 403(b) Plans

- ◆ Governmental and church employers are exempt from ERISA
- ◆ Other employers may avoid being an ERISA plan by complying with “safe harbor”

Non-ERISA Safe-Harbor

- ◆ Employee participation completely voluntary
- ◆ Salary reduction arrangement only
 - Employers' responsibilities:
 - ◆ Collect and remit \$ to vendor
 - ◆ Maintain collection records
 - ◆ Ensure that employees' W-2 income and tax withholding are properly adjusted for payroll taxes
- ◆ All rights solely enforceable by employee

Non-ERISA Safe-Harbor

- ◆ Allowable Activities (FAB 2007-2)
 - Review program structure and operation for tax compliance defects
 - Ensure program is 403(b) tax compliant
 - Develop administrative processes and obtain cooperation of vendors to correct tax defects
 - Keep records of plan activities
 - Permit vendors to publicize their products
 - Compile information to facilitate employee review
 - Limit number and selection of vendors to give employees a reasonable choice

Activities Inconsistent with Non-ERISA Safe Harbor

- ◆ Authorizing plan-to-plan transfers
- ◆ Processing distributions
- ◆ Making determinations regarding hardship distributions, QDROs and eligibility for or enforcement of loans
- ◆ Negotiating with annuity providers or account custodians to change the terms of their products



Fiduciary Issues

Fiduciary Liabilities

ERISA vs. NON-ERISA 403(b)

ERISA

NON-ERISA

Fiduciary standards under Federal law applies	<ul style="list-style-type: none"> • State tort law applies • CA governmental agencies subject to State law
Personally and jointly liable	Personally liable; joint liability probably dependent on case law
Liability limited to actual losses	Liability exposure includes losses and punitive damages
Fairly standard practices developed since 1974	Relatively new, developing area of litigation

Fiduciary - General Definition

"One, such as an agent of a principal or a company director, that stands in a special relation of trust, confidence, or responsibility in certain obligations to others."

ERISA Fiduciary Standards

- ◆ Fiduciary - anyone with decision making authority over the plan and/or plan assets
- ◆ Fiduciaries are charged with:
 - Acting solely for the benefit of plan participants
 - In a prudent manner
 - Acting based on the knowledge and experience of an expert
 - Avoiding conflicts of interest
 - Allowing only “reasonable” expenses to be charged to participant accounts

Potential Fiduciaries

- ◆ Board of Directors
- ◆ Officers
- ◆ Anyone with authority over the plan and/or plan assets, including:
 - Plan compliance
 - Plan investments
 - Claims
 - Distributions
 - Plan provisions and/or benefits

403(b) Plan Fiduciary Liability Exposure

- ◆ 403(b) plan fees scrutiny, a new focus of litigation
 - Major class action suit filed against National Education Association's 403(b) plan July 2007
 - ◆ Allegation was breach in fiduciary duties by charging excessive and unreasonable fees that materially reduced participant account balances
 - SEC article "Evaluating Your Retirement Options" focuses on fees charged by investment vendors to 403(b) plan participant accounts

403(b) Plan Fiduciary Liability Exposure

◆ Emerging issues

- Investment manager performance
- Investment information provided to plan participants
- Employer plan technical compliance responsibility
- Selection and monitoring of plan administration vendor



Next Steps

Next Steps

- ◆ Develop a plan to achieve/maintain compliance
 - Establish committee charged with 403(b) compliance responsibility
- ◆ Determine actions to take
- ◆ Develop process to carry out actions

The Process

- ◆ Evaluate effects of Final Regulations
- ◆ Identify and fix any current compliance issues
- ◆ Determine if the plan is or will be an ERISA plan
- ◆ Comply with the plan document requirements, contract and reporting requirements before 2009
- ◆ Develop processes and procedures to monitor plan compliance

The Process

- ◆ Inventory vendor relationships, active and inactive
 - Determine if inactive vendor assets are eligible for grandfathering
 - Obtain copies of individual contracts and/or custodial agreements, employee communications, prospectuses and related materials from all vendors
 - Establish process to protect tax status for accounts held by inactive vendors

The Process

- ◆ For post-2008 vendors:
 - Determine responsibilities for vendors
 - Obtain and review updated vendor contracts
- ◆ Determine who will be responsible for plan compliance (Plan Compliance Manager)
- ◆ Establish procedures to monitor Plan Compliance Manager

The Process

◆ If non-ERISA plan:

- Establish and document procedures to stay within “safe harbor”
- Evaluate past and present vendors to ascertain if the plan has the vendor relationship going forward
- Consider limiting number of vendors

The Process

- ◆ If an ERISA plan:
 - Evaluate past and present vendors to ascertain if the plan has the vendor relationship going forward
 - Consider consolidation to a single vendor
 - Review vendors' investment line-up and fees
 - Gather, or engage a firm to help you gather, plan accounts data to prepare for 2009 plan year independent CPA audit if applicable
 - Consider hiring a third party to establish and monitor processes and procedures to maintain compliance and limit liability exposure

Summary

- ◆ It is a New World for 403(b) plans
- ◆ Liability exposure management is the necessary and least expensive alternative



Appendix A

403(b) Plan Overview

What Employers Can Have a 403(b) Plan?

- ◆ Code Section 501(c)(3) organizations - tax-exempt organizations
 - Organized for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international sports competition, or for the prevention of cruelty to children or animals
- ◆ Public educational organizations
- ◆ Licensed church minister or an organization that shares religious bonds with such minister that it employs

Maximum Deferral Limits

- ◆ \$15,500 (Code Sec 402(g))
- ◆ Special catch-up contribution for 15 years of service employees of educational organizations, hospitals, health and welfare service organizations and church related organizations. The lesser of:
 - \$3,000,
 - Excess of \$15,000 over prior year special catch-up contribution deferrals with current employer, or
 - Excess of \$5,000 X years with the employer, over total prior year deferrals with employer
- ◆ \$5,000 catch-up contribution for employees age 50 and over (Code Sec 414(r))

Roth Contributions

- ◆ Roth (after-tax) contributions are allowed subject to the following:
 - Plan must separately account for Roth contributions
 - Limits remain the same – treated like deferrals for purposes of contribution limits and distribution rules
 - Qualified distributions (made after 59 ½ or made after death) not taxed if distribution is made after 5 year holding period (begins first year of Roth contribution)

Employer Contributions

- ◆ 403(b) plans that allow employer contributions are ERISA plans
- ◆ Employer contributions are subject to:
 - Nondiscrimination testing under Sec 401(a)(4)
 - Minimum coverage testing under Sec 410(b) of the Code
 - ACP testing under Code Sec 401(m) for matching contributions
- ◆ Combined employer & employee contributions cannot exceed:
 - \$46,000 dollar limit, or
 - 100% of compensation under Sec 415(c) of the Code.
 - Alternate limit for churches of \$10,000 if 100% of compensation is exceeded (\$40,000 lifetime maximum)

Employer Contributions

- ◆ An employer can make contributions to former employees
 - Deemed to have monthly compensation for the period through the end of the taxable year in which ceases to be an employee and through the end of each of the next 5 taxable years
 - Must not exceed the lesser of the
 - ◆ Dollar limit of \$46,000 for 2008, or the
 - ◆ Compensation based on the former employee's average monthly compensation during most recent year of service
 - Cannot discriminate in favor of former employees who are HCEs



Appendix B

Why is Compliance Important?

Results of Non Compliance


- ◆ **Aggregation of contracts:** Failure to satisfy the 403(b) requirements with respect to any contract issued adversely affects (jeopardizes the favorable tax treatment of) all section 403(b) contracts issued to that individual
- ◆ **Operational failures:** Affects the favorable tax treatment for employee or employees to whom the operational failure occurred
- ◆ **Other failures:** Adversely affects all contracts issued under the plan. Includes:
 - Plan document failures
 - Failure to meet the nondiscrimination requirements
 - Failure of the employer to be an eligible employer

Common Compliance Violations

- ◆ Eligibility - Universal availability
- ◆ Loans
- ◆ Distributions
- ◆ Controlled group non-discrimination testing
- ◆ Contribution limits

Costs of Non-Compliance

- ◆ Defense expenses
 - Fees to professionals
 - Affect on employee relations
 - Diversion of resources
 - Loss of productivity
- ◆ Penalties assessed against employer
- ◆ Taxes assessed to plan participants



Appendix C

Best Practices Issues And Considerations

Plan Administration

- ◆ A Multitude of vendors can mean:
 - Higher participant plan costs
 - Added complexity to plan compliance and administration
 - Lack of clear vendor responsibility for and/or participation in plan compliance
 - Lower plan administration service quality
 - Absence of independent, knowledgeable selection and monitoring of plan investments
- ◆ The employer remains liable for compliance breaches

Vendor Selection Criteria

- ◆ Will vendor accept fiduciary responsibility for:
 - Plan compliance
 - Investment selection and monitoring
- ◆ Will vendor indemnify employer for compliance failures?
- ◆ Are procedures in place to identify and avoid potential vendors' conflict of interests?
- ◆ Does vendor offer a complete universe of investment managers or only its own products?

Corporate Governance

- ◆ Employers can no longer avoid “being involved” in a 403(b) plan
- ◆ Best Practices
 - Written Investment Policy with periodic monitoring
 - Periodic plan expense review
 - Effective communication to employees
 - Documented procedures to assure compliance
 - ◆ Plan Administration and Investments Committee
 - ◆ Clear delegation of responsibilities from Board of Directors
 - ◆ Periodic reporting to Board of Directors



Appendix D

401(k)/ERISA/NON-ERISA 403(b) Plan Comparison

401(k)/ERISA/NON-ERISA 403(b) Plan Comparison

	401(k)	ERISA 403(b)	Non-ERISA 403(b)
Elective deferral contributions - limit 2008 \$15,500	Yes	Yes	Yes
Elective deferral catch-up contributions - limit 2008 \$5,000	Yes	Yes	Yes
Special catch-up for 15 years of service max \$3,000	No	Yes	Yes
Roth contributions	Yes	Yes	Yes
Employer matching contributions	Yes	Yes	No
Employer contributions for former employees	No	Yes	No
Employer profit-sharing contributions	Yes	Yes	No
Frequency of deferral elections	Yes	Yes	Yes
Minimum distribution rules	Yes	Yes	Yes
Investment alternatives limited to annuity contracts and mutual funds	No	Yes	Yes

401(k)/ERISA/NON-ERISA 403(b) Plan Comparison

	401(k)	ERISA 403(b)	Non-ERISA 403(b)
Plan Document required (as of 1/1/2009 non-ERISA 403(b))	Yes	Yes	Yes
SPD, Form 5500 & SAR	Yes	Yes	No
Elective deferral ADP testing	Yes	No	No
Universality Requirement	No	Yes	Yes
Termination of Plan	Yes	Yes	Yes
Loans & Hardship provisions	Yes	Yes	Yes
ERISA fiduciary responsibilities	Yes	Yes	No
State law governance	No	No	Yes
Incidental death benefits	Yes	No*	No*
*Existing insurance grandfathered			