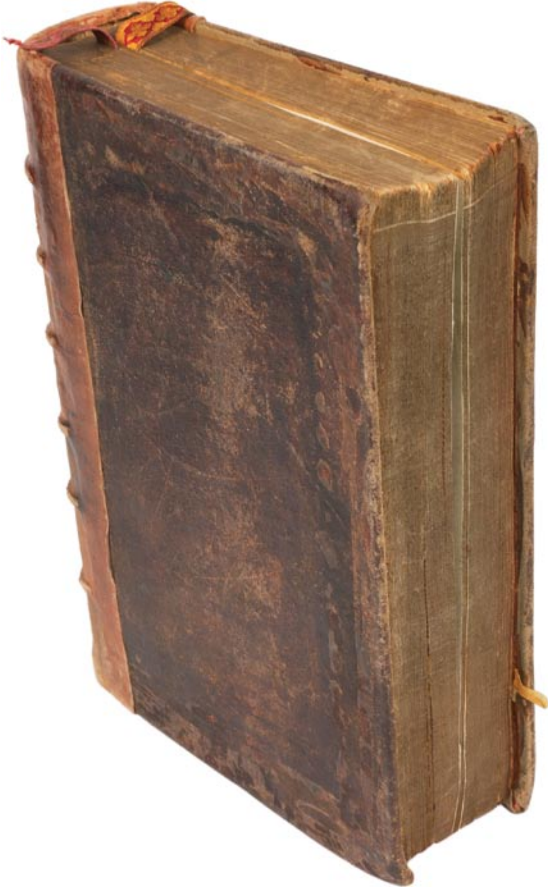

Separating fact from fiction

about the final 403(b) regulations for public organizations

We are the ANSWER.

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Final 403(b) regulations have been published and generally become effective on January 1, 2009. There's been plenty of buildup, discussion, information and misinformation talked about while plan sponsors and plan providers waited for the final word. Now that the final word is here, what now?

When major regulatory changes happen, decision makers in public organizations, like you, need straight information about what they require. You must be able to step up and make informed decisions about allocating resources.

This brochure gives you the straight scoop on the new 403(b) regulations in language you can understand. We answer five important questions (shown below).

- ✓ Is all of this new?
- ✓ Are the employer responsibilities new?
- ✓ Has everyone just been ignoring the rules until now?
- ✓ So what is new?
- ✓ Am I going to become a fiduciary?

Is all of this new?

No. There's no question that the regulations require more attention from plan sponsors to their 403(b) programs. However, existing rules in place since the mid- and late1980s already require that attention. These existing requirements include the following:

- ✓ Universal availability
- ✓ Deferral limitations
- ✓ Withdrawal restrictions
- ✓ Minimum distribution requirements

These requirements were all in effect before 1990 and have been the focus of IRS 403(b) audits since the mid-1990s.

Contrary to comments in recent articles and presentations, participants have not previously been permitted to treat their 403(b) accounts as unrestricted "checking accounts." Withdrawal restrictions on employee elective deferrals have been required under 403(b) annuity contracts and custodial accounts since 1989. The restrictions were even a subject of guidance from the SEC, which made an exception to its general rule that securities, such as variable annuities, be effectively available for withdrawal upon demand.

If someone tells you these rules are new under the regulations, perhaps these existing regulations are simply new to him or her. And that is the kind of problems the IRS audits look for.

Are the employer responsibilities new?

No. Employer responsibility for compliance is not new. If one of these rules is violated, and if that violation is not corrected, affected participants lose their exclusion for contributions in the affected year(s). That means that you, as the employer, become responsible for income tax withholding on those contributions that you treated as tax deferred.

In layman's terms, such an error can be the foundation for an IRS 403(b) audit. Employers already have compliance responsibilities, including the responsibility to assure that 403(b) contributions are made to providers with contracts that meet 403(b) requirements. For example, if the IRS discovers that your employees are contributing to a provider that has disregarded 403(b) withdrawal restrictions, the IRS will look to you to fix the problem and possibly pay a penalty.

Has everyone just been ignoring the rules until now?

No. Many public institutions have sought for many years to assure the tax compliance of their 403(b) program through agreements requiring providers to accept responsibility for tax compliance. These responsibilities include the following:

- ✓ Monitoring deferral limitations
- ✓ Restricting loans and distributions in accordance with the 403(b) limitations
- ✓ Notifying employees of the need to begin taking distributions at age 70½ (or upon retirement, if later)

These agreements have taken on different names in different times and different places, such as "hold harmless agreements," "indemnification agreements," "service provider agreements" and probably other names as well. It isn't the name that is important, but instead what the agreement requires. These agreements pose the following question to the provider: Are you prepared to stand behind the provisions of your contract and fulfill your commitment to the plans, the employers and the participants?

There are some things individual providers cannot do on their own, at least not without additional information. These functions include monitoring deferral limitations across multiple providers and ensuring that employees do not take the same hardship withdrawal twice or take excess loans by using multiple providers.

On the other hand, there are some compliance requirements that plan providers can and should agree to assume, such as notifying employees of the amounts needed to fulfill the required minimum distributions after age 70½ or retirement, if later.

So what is new?

The two new provisions that have received the most attention are listed below:

- ✓ The requirement for a written plan, and
- ✓ Restrictions on nontaxable transfers to other 403(b) contracts or accounts

Written plan

Final regulations permit the written plan requirement to be satisfied in a number of ways, depending on what works best for the plan sponsor. So, for example, an employer could maintain separate plan documents for employee deferrals and employer contributions (such as properly structured special pay contributions in lieu of accumulated sick and vacation time). Further, certain of the written plan requirements may be satisfied by the written terms of the providers' contracts and need not be replicated in the employer's plan documents. A collection of documents could potentially constitute the written plan.

Employers can expect many of their providers, and other parties as well, to offer up sample plan documents. NOTE: Any references to "prototype documents" would be inaccurate, as there is no program today for the IRS to approve prototype documents. However, stay tuned, because that could change. Documents offered by providers and other parties should be vendor-neutral to work with multiple 403(b) contracts and accounts. Employers can also expect the IRS to publish sample plan language.

In any case, the requirement to have a written plan document should not of itself be a significant burden. In most instances, it should require nothing more than the one-time adoption of a document, then occasional updates for changes in tax law.

Transfers

Final regulations restrict future 403(b) transfers to those specific products that are authorized under the employer's plan, including:

- ✓ Products from providers approved to receive ongoing contributions and transfers
- ✓ Providers that have entered into agreements to provide compliance support and are thus eligible to receive transfers

This situation makes it important for an employer to know whether a provider will restrict such transfers to the employer's approved list. If participant accounts are maintained on an individual basis, without reference to an employer, that may be a very difficult requirement for a provider to apply. However, if accounts are systematically aggregated at the employer group level, as AIG VALIC and some other companies do, enforcing these new restrictions is much simpler.

Am I going to become a fiduciary?

There is nothing in the final 403(b) regulations that states or implies that employers are fiduciaries with respect to the 403(b) products purchased for their employees. Quite the contrary, the final regulations confirm that even voluntary 403(b) plans of private tax-exempt employers, which do not enjoy the governmental plan exemption from Title I of ERISA, may still be maintained with very limited employer involvement.

The Department of Labor confirmed this point in a Field Assistance Bulletin, noting that the continued availability of an existing exemption for voluntary deferral plans depends on the extent of the employer's involvement. However, depending on state law and the scope of the responsibilities that a public employer has elected to assume under the plan, that employer may take on new responsibilities (whether or not characterized as fiduciary responsibilities) that are greater than those imposed under the 403(b) regulations.

You may have read or heard analysis on this topic recently. In some cases the analysis addresses individual states, while in other cases the topic is addressed only very generically. It is always possible that a specific state's laws, regulations or common law could impose broad fiduciary or fiduciary-like responsibilities on a public employer sponsoring a 403(b) plan. Plan sponsors should consult legal counsel for specific advice regarding their plans. However, as a general matter, this topic presents several opportunities for confusion and misdirection. For example:

- ✓ It is true that most state-defined benefit pension and retirement systems, and some state 457(b) plans, are subject to explicit fiduciary duties under the governing state statutes and regulations. It is also true, however, that these same statutes and regulations generally do not apply to a school district's 403(b) plan. Of course, specific duties and considerations may apply to the handling and timely remittance of contributions. State or local procurement rules and similar rules may govern the process of provider review and selection. Identifying such duties, rules and considerations, however, generally is very different from imposing broad ERISA-like fiduciary duties on a public school 403(b) plan sponsor.

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(continued from *Am I going to become a fiduciary?*)

- ✓ In a few states – including California, Texas and Ohio – a school district is specifically prohibited from excluding a provider or product from receiving new contributions under the plan as long as the provider and product satisfy applicable state requirements. As a general matter, those state requirements include satisfying the requirements of Code Section 403(b). In California and Texas, the requirements also include participation in a state registry of eligible providers and/or products. As a general matter, however, a school district is normally permitted to exclude a product which does not satisfy the requirements of Code Section 403(b).
- ✓ In some states, an employer that takes a more active role in reviewing the underlying products, over and above its review of the product's compliance with the requirements of Section 403(b), might itself trigger a heightened level of duty to participants. However, any discussion of potential liability that might be associated with narrowing the field of available products within the 403(b) plan should also consider the potential application of sovereign immunity principles to a public employer's plan, particularly in the absence of specific legal rules imposing a defined set of fiduciary obligations to that function.

In any case, if and to the extent state law imposes responsibilities on employers, those responsibilities are not changed or enlarged by the 403(b) regulations.

Of course, a public employer is free to voluntarily assume fiduciary, or fiduciary-like, responsibilities under their 403(b) plan, assuming no restrictions on the assumption of such responsibilities under state law. However, it is important to distinguish among a public employer's tax compliance responsibilities, its legal responsibilities to employees under state law, and whatever non-legally mandated actions it chooses to take to provide a quality program for its employees. Fiduciary status would increase a plan sponsor's potential liabilities, and an employer should not take action that assumes or implies that it has such responsibilities without careful consideration and unbiased legal advice.

AIG VALIC has the background and expertise to help you separate FACT from FICTION when it comes to the final 403(b) regulations. Ask us any question.

WE ARE THE ANSWER.

Contact your information source on 403(b) regulations at
1-877-403bREG (2734) or visit **www.aigvalic.com**

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