403(b) UPDATE: MORE GUIDANCE, MORE QUESTIONS

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Recent Guidance on 403(b) Plans

Announcement 2009-34

One of the changes implemented by the new 403(b) regulations is the requirement that all 403(b) arrangements be maintained in accordance with a written plan, including governmental and salary reduction only plans that had never had a plan document requirement before. This requirement set off a whirlwind of activity in the plan drafting community. But because the plan document requirement was a new one under 403(b), some of the tools that 401(a) qualified plan sponsors use to meet the need for a plan document, such as prototype plans and determination letters, were not available to 403(b) plan sponsors.

On April 14, 2009, the IRS issued Announcement 2009-34, setting forth its intention to establish a prototype plan program for 403(b) plans and, later, a determination letter program. The program, described in a draft Revenue Procedure, will be similar to the program that currently applies to qualified plans. The prototype plan program will allow a prototype plan sponsor to get an opinion letter from the IRS that the form of its plan complies with the requirements of 403(b).

The Announcement describes a prototype plan as a two part plan document intended to satisfy the requirements of 403(b) and the regulations. The first part of the document, called the basic plan document, contains provisions that will apply to any adopting employer's plan, and can't be modified. The second part of the document, the adoption agreement, provides the employer the opportunity to make elections and customize the plan.

Eligible employers that adopt an approved prototype plan will generally be able to rely on that plan document without getting their own determination letter. Under the Announcement, the IRS will approve two types of plans: a "standardized plan" and a "nonstandardized plan." A plan is standardized if the plan allows elective deferral contributions and, for any other contributions, automatically satisfies uniform coverage and contribution standards. A plan is nonstandardized if it does not meet the definition of standardized. When a plan is standardized, the adopting employer can rely on the opinion letter obtained by the prototype sponsor. When a plan is nonstandardized, the employer can rely on the letter except for whether the contributions satisfy with the non-discrimination rules.

In the Announcement, the IRS identified a list of requirements that must be met by the plan under the prototype program. Important requirements include the following:

- The plan must contain all the material terms and conditions for eligibility, benefits, applicable limitations, the investment arrangement available under the plan, and the time and form of benefit distributions
- The plan must satisfy the universal availability requirement with respect to elective deferrals
- The plan must limit the amount of compensation that can be taken into account with respect to any contribution to the limitation under section 401(a)(17)
- If the plan is subject to non-discrimination testing under section 401(m), it must have a provision that meets the applicable requirements if it provides for matching or after tax employee contributions
- The plan must set forth the terms governing any hardship distributions, loans, plan-to-plan transfers, contract-to-contract exchanges, and rollovers into the plan
- Every plan must provide for full and immediate vesting of all contributions under the plan
- Every plan must provide that in the event of any conflict between the terms of the plan and the terms of any annuity contract or custodial account under the plan, or of any other document that is incorporated by reference in the plan, the terms of the plan shall control

The proposed program would also effectively provide sponsors of 403(b) plans with a remedial amendment period. An eligible employer would be able to retroactively correct defects in the form of its 403(b) plan by adopting an approved prototype plan or (when the determination letter program is available) a request for a determination letter. To obtain this relief, the plan must be amended to correct any form defects retroactively to the later of January 1, 2010 or the effective date of the plan.

The IRS stated that it intended that the prototype program would be available to be used by "most eligible employers." However, there are some aspects of the proposal that may greatly limit the appeal of the program and have raised concerns and questions among potential users. These include:

- The requirement noted above that the program does not allow for delayed vesting. The IRS stated that it did not believe that this was a common provision in 403(b) plans. In fact, as was noted in a number of comments, a significant percentage of 403(b) plans do contain a delayed vesting provision.
- The program and the model language provide for very limited flexibility in plan design, including in such areas as permissible contribution schedules, waiting periods, and excludible categories of employees. This could prevent the program's use by plans that have more complex designs.
- The requirement noted above that the program requires that the plan supersede any conflicting provision in a funding vehicle. Because of the complex nature of the funding vehicles used in 403(b) plans and the difficulty or impossibility of changing their terms, this rule could result in inadvertent operational failures.

The IRS also issued some draft sample plan language, and invited comments on the language and on the draft Revenue Procedure. The IRS has publicly stated that, as of early September, there were about 20 comment letters submitted, many of which expressed concerns about the above provisions as well as others. An IRS official has said that the Service is receptive to the suggestions made and will go back and take another look at the program as a result of the comments. It appears likely, for example, that delayed vesting will be permitted as part of a 403(b) prototype plan. The IRS is also likely to address the issue of the treatment of conflicts between the terms of the plan and the funding vehicles.

Field Assistance Bulletin 2009-2

Along with the issuance of final regulations for 403(b) plans by the IRS, the Department of Labor "DOL" released new rules for the Form 5500s that needed to be followed by 403(b) plans required to file such forms effective in plan year 2009. A major element of this change is the requirement that "large" ERISA covered plans (generally those with 100 or more participants) file audited financial statements. Prior to this change, 403(b) plans were not required to maintain the records that now need to be audited. For example, prior to the final IRS regulations many plans allowed participants to transfer to 403(b) funding vehicles that were not selected by the plan sponsor and without the plan sponsor's knowledge or involvement. Consequently, it will be difficult, if not impossible, for many 403(b) plan sponsors to identify all of the contracts that would need to be included in the audit and to determine the plan assets as of January 1, 2009. Plan sponsors were facing the unhappy prospect that their auditors would issue qualified or adverse opinions because they would be unable to certify that the plan assets were being reported correctly.

In DOL Field Assistance Bulletin ("FAB") 2009-02, issued on July 20, 2009, the DOL acknowledged this problem and issued transitional relief. The FAB provides that certain contracts do not need to be included in the plan for purposes of the Form 5500 reporting requirements. A plan need not include a contract as part of the plan if the plan administrator makes a good faith effort to transition to the new reporting requirements, and:

1. the contract or account was issued to a current or former employee before January 1, 2009;
2. the employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and in fact ceased making contributions to the contract or account before January 1, 2009;
3. all of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer; and
4. the individual owner of the contract is fully vested in the contract or account.

The DOL also said that in counting the number of participants in a plan (which may be important for determining if the plan is "large"), employees who only hold contracts that can be excluded under the FAB do not need to be included in the count. And, the DOL will not reject a Form 5500 with a qualified or adverse opinion if the auditor states that its reason for qualifying the opinion is based solely on the exclusion of the contracts described in the FAB.

The FAB is extremely helpful in resolving some of the issues faced by sponsors, but there were some immediate questions, including:

- Is the FAB applicable to only the 2009 Form 5500, or can these contracts be excluded in all subsequent years? The DOL has since stated informally that contracts that meet the listed criteria can be excluded in all subsequent years.
- What constitutes "involvement of the employer" for purposes of meeting the third requirement for contracts to be excluded from the plan? It appears that this will be a facts and circumstances determination, leaving some room for uncertainty. However, DOL officials have recently stated that with respect to the "involvement of the employer" requirement, a contract will be entitled to relief under the FAB unless an employer exercises discretionary authority over the contract.

In addition, the American Institute of Certified Public Accountants ("AICPA") has commented that while the FAB explains DOL's enforcement position, auditors still need to follow the applicable auditing standards. It appears that auditors may be looking for plan administrators to demonstrate that they have made a "good faith" attempt to find the information needed for an audit, even for contracts that the FAB otherwise permits the administrator to disregard. It is unclear what constitutes a "good faith effort" under the FAB.

Operational Issues in Implementing the Regulations

1. <u>Loans, Hardship Withdrawals, and Sharing Information Among Vendors</u>

Many questions have surfaced regarding the application of the rules under the final regulations requiring that information be shared among the investment providers in a plan before distributions are made. Unlike 401(k) plans, 403(b) plans typically do not have a single recordkeeper. It is very common for each investment provider to keep its own records for the accounts that it holds, and not to communicate with the other investment providers. Further complicating the picture is Rev. Proc. 2007-71, which sets up rules for determining when an investment provider is considered to be part of a plan. Rev. Proc 2007-71 establishes various standards that can be used to comply with the regulations when attempting to share information with investment providers who may no longer be included in the plan. Following are some examples of typical questions that have arisen in this area:

a. A plan participant requests a loan from the plan under an annuity contract issued by an investment provider that is currently a designated provider under the plan. The participant already has an outstanding loan from a plan provider that was eliminated from the plan in 2007. The combination of the two loans would cause the second loan to exceed the limitations of section 72(p). The employer tries to get information about the loan from the eliminated provider in a manner prescribed by Rev. Proc. 2007-71 (in accordance with the "good faith" standard in the revenue procedure), but without success. Can the employer approve the issuance of the second loan without knowing if the loan may be in excess of the statutory limits?
b. A plan participant requests a loan from an investment provider pursuant to the annuity contract issued to her by that provider. The provider is no longer a designated provider under the plan. Before issuing the loan, the provider contacts the employer to find out if the participant has any other loans outstanding. The employer does not communicate with the investment provider. Can the investment provider issue the loan to the participant without knowing if the loan would be in excess of the statutory limits?
c. A plan participant requests a hardship withdrawal from an investment provider. Before approving the request, the investment provider checks to see if the participant has any accumulation available for a loan first, as is required under the applicable hardship withdrawal regulations. The participant does not have amounts available for a loan with the investment provider, but does have an accumulation with another investment provider. The second investment provider does not allow loans out of its custodial account. Is the participant required to transfer his accumulation from the second

investment provider to the first in order to take a loan prior to obtaining a hardship distribution? What if the transfer would cause the participant to incur a surrender charge?

2. Application of Notice 2009-03

In Notice 2009-03, the IRS delayed the application of the plan document requirement under the final regulations for 403(b) plans from January 1, 2009 until December 31, 2009 if certain conditions were met. The Notice states that a 403(b) arrangement will be in compliance with the final regulations if:

- By December 31, 2009, the plan sponsor of the plan has adopted a written 403(b) plan that is intended to satisfy the requirements of 403(b) and the final regulations, effective as of January 1, 2009;
- During 2009, the plan sponsor operates the plan in accordance with a reasonable interpretation of 403(b) and the related regulations;
- By the end of 2009, the plan sponsor makes its best effort to retroactively correct any operational failure during the 2009 calendar year to conform to the written plan.

The employer discovers that, despite its explicit direction to the contrary, one investment provider has continued to allow employees to self certify to the hardship requirements after January 1, 2009. This has resulted in 10% of the hardship withdrawals in 2009 being processed although the participant had other amounts available that could have been withdrawn from the plans. Has the employer been operating its plans in accordance with Notice 2009-03 requirement that plans be operated in accordance with a reasonable interpretation of 403(b), taking into account the final regulations? Does this constitute an operational failure that needs to be corrected before the end of 2009? If yes, what would constitute "best efforts" to correct this failure?

3. ERISA "Safe Harbor" Plans

Under section 2510.3-2(f) of the regulations under ERISA, a 403(b) plan may be considered as not "established or maintained by an employer" and therefore not a pension plan under ERISA if certain factors are met: 1) participation of employees must be completely voluntary, 2) all rights under the annuity contract or custodial account funding the plan must be enforceable solely by the employee or beneficiary, 3) the involvement of the employer is limited to certain optional specified activities, and 4) the employer must receive no direct or indirect compensation except for expenses incurred in administering the salary reduction agreements. There has been considerable discussion about the permissible limits of the employer's activities before the employer's involvement causes the plan to fail to meet the safe harbor. In general, the Department of Labor will treat a plan as covered by ERISA if the employer is making discretionary determinations with respect to that plan (see, Department of Labor Field Assistance Bulletin 2007-02.)

a. Under the safe harbor, the employer can only limit the funding vehicles to what constitutes a "reasonable choice" to employees under all relevant circumstances. Under what circumstances, if any, can a plan fall within the ERISA safe harbor when it has only one investment provider?
b. Can the employer be responsible for determining whether an employee is eligible for a loan by calculating the outstanding balances of his or her other existing loans?
c. If the employer is not permitted to make discretionary determinations about, e.g., loans and hardship withdrawals, can it hire a TPA to do take on those responsibilities?
d. If an employer decides it wants to convert a safe harbor plan into an ERISA plan, can it do so in a way that maintains the non-ERISA status of the accumulations in the safe harbor plan up to the point of the conversion?
e. If an employer determines that it has been erroneously operating a plan as a safe harbor plan, what correction steps should it take?

4. <u>Plan Terminations</u>

Section 1.403(b)-10 of the regulations, describes how a 403(b) plan can be terminated. In order to terminate a plan in accordance to these rules, all accumulated benefits to participant must be distributed to all participants and beneficiaries as soon as practicable. For purposes of this distribution requirement, delivery of a fully paid individual insurance contract is treated as a distribution. The IRS has said that the same rule applies to certificates under a group annuity contract.

a. If a plan is funded in whole or in part with individual or group custodial accounts, how does the administrator meet the requirement that all accumulations be distributed? This is a particular issue where the custodial account agreements do provide for a distribution at the direction of the employer.
b. Under what circumstances will the termination of a safe harbor plan cause the plan to because subject to ERISA?
c. If the employer was operating a multiple 403(b) plans but wanted to terminate only one of them, how can it determine that the various plans will in fact be treated separately for ERISA purposes?

GETTING OVER THE 403(b) HUMP: A TO-DO LIST FOR THE NON-INITIATE

The IRS's issuance of the section 403(b) regulations in July, 2007[1] dramatically changed the regulatory life for 501(c)(3) organizations, churches and state educational organizations. What is particularly striking about the change is that it is not accompanied by a fundamental statutory change, and the number of rules which have changed is relatively limited. The changes that were made, however, are having a wide ranging effect.

403(b) plans have not been a significant focus of many employee benefit practitioners because the historical IRS enforcement efforts have not been substantial and, and the fact that the tax impact and the responsibility for the proper operation of the plans were either the responsibility of the plan participant or the vendor. One of the key changes of the final regulations is to force more accountability on employers, and this underlies the impact of the regulatory change. Now benefit practitioners, many who support charitable organizations on a reduced fee or on a pro bono basis, are confronted with a newly complex set of rules with which they are generally unfamiliar.

The purpose of this overview is to provide practitioners with a simplified overview of what needs to be done to these plans, and by when, to meet the new requirements.

I. EFFECTIVE DATES

The regulations, as issued, had a general effective date of January 1, 2009.[2] Delayed effective dates applied to certain types of plans, including:

- Certain plans maintained pursuant to a collective bargaining agreement
- Certain plans maintained by a church related organization
- Certain plans that now needed to permit elective deferral contributions from employees who previously could be excluded.

In addition, the contract exchange rules applied to all exchanges that occurred after September 24, 2007.

[1] 72 Fed. Reg 41128 (July 26, 2007)

[2] Treas. Reg. 1.403(b)-11 contains the effective dates

However, on December 11, 2008, the IRS issued Notice 2009-3, offering some relief to plans by providing a limited delay of one year in the effective date. The Notice states that a 403(b) arrangement will be in compliance with the final regulations if:

- By December 31, 2009, the plan sponsor of the plan has adopted a written 403(b) plan that is intended to satisfy the requirements of 403(b) and the final regulations, effective as of January 1, 2009;
- During 2009, the plan sponsor operates the plan in accordance with a reasonable interpretation of 403(b) and the related regulations;
- By the end of 2009, the plan sponsor makes its best effort to retroactively correct any operational failure during the 2009 calendar year to conform to the written plan.

II. BASIC CONCEPTS

There are a few basic 403(b) concepts of which the practitioner should be are aware in approaching the overview. This includes the following:

- 403(b) plans are still fundamentally different than 401(a) plans. There are only a limited number of "qualification rules" which apply to 403(b) plans; only a limited number of 401(a) type of rules actually apply to 403(b) plans; and a number of 401(a) rules which apply to 403(b) plans have different twists to them of which the practitioner needs to be wary when providing counsel. In particular, there are still a number of significant differences between 403(b) plans and 401(k) plans, including non-discrimination rules and contribution limits.

- An employer may have limited authority under a 403(b) plan. Many 403(b) plans are funded, at least in part, with contracts or custodial accounts which are owned by the individual participant, not by the plan, and many typical activities (such as the correction of excess contributions) are beyond the control of the plan administrator. Further, non-ERISA 403(b) plans may not even have a plan administrator or any identifiable party with authority over the plan. Of particular relevance to these regulations, non-ERISA 403(b) plans are frequently operated without a written plan document.

- Private employers' 403(b) plans for its rank and file employees may be exempt from ERISA Title 1 coverage.[3] The Department of Labor has issued guidance under which ERISA Title I will not apply if the plan falls within a certain safe harbor. Identifying which plans are governed by ERISA and which are not is a critical part of the process of dealing with 403(b) plans. Significant questions have been raised about the relationship between the safe harbor and the requirements that the final regulations put on employers who offer such plans.

- Before doing anything, assess the plan. 403(b) plans have been generally disregarded by many employers, because they were often seen as individual pensions and were

[3] 29 CFR 2510.3-2(f) outlines the DOL's safe harbor provision for tax sheltered annuities, as 403(b) plans are often called.

generally treated as such. Find out as much as you can about the plan, and even assess whether it should (or could) be terminated. Remember that even in plans that have written documents many of the terms may be contained in the annuity contracts and custodial accounts.

- Multiple vendor/Multiple product/Multiple Custody environment. Likely the quirkiest feature of the 403(b) plan is that (with the exception of a growing number of larger plans), the funds are not centralized and the products and their vendors are not uniform. Each vendor separately manages the participant accounts that it holds, with little, if any, communication between vendors and employers. This makes it far more difficult to manage than your typical 401(a) plan. It also was a focus of concern for the IRS and Treasury in issuing the final regulations, because they believed the lack of communication between vendors and employers resulted in plans failing to comply with section 403(b) and other tax rules.

III. THE TO-DO LIST

1. Written Plan Document

Requirement: All 403(b) plans, except for those churches with retirement income accounts in which there are no annuity contracts, must be maintained pursuant to a written plan document. Critically, the continued tax favored treatment of the plan depends upon the plan complying in both form and operation with the requirements of 403(b)[4]. There is no remedial amendment period for 403(b) plans, so the written plan must be in place generally by December 31, 2009. [5]

The IRS has said that the written plan requirement can be met by using a variety of documents that may currently exist if they contain all the elements necessary for a written plan. Thus, the annuity contracts, custodial agreements and other documents used to communicate the terms of the plan and how it is administered can be combined to constitute a written plan.[6] But particularly in a multiple vendor plan, the better practice in most cases will be to have a single plan document.

Another critical issue to address when drafting a written plan is the relationship between the annuity contracts and custodial agreements and the terms of the plan. If there is a conflict between the terms of a contract and the provisions of the plan, it may be impossible to administer the plan in accordance with its terms. For example, if the plan does not allow for participant loans, and the annuity contract being used to fund the plan

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4 Treas. Reg. 1.403(b)-3(b)(3).

5 See above for the change in the written plan effective date under Notice 2009-03. The exceptions for certain collectively bargained plans, government plans and those maintained by a convention of churches also noted above can be found in Treas. Reg. 1.403(b)-11.

6 *See* preamble at 72 FR 41130.

does allow for loans, participants may have the right to obtain a loan notwithstanding the terms of the plan.

To Do:

- If there is not already a formal plan document, determine whether the documents currently used in the 403(b) arrangement (e.g., annuity contracts, custodial accounts, communications to employees, recordkeeping agreements) are sufficient to meet the written plan requirement. If not, or if having a single document is simpler to administer, adopt a new plan document. Exercise caution when using the IRS model plan document[7]– but remember that it is very limited, makes certain assumptions about the operation of the plan which may not be applicable, and is written for governmental salary reduction plans only.
- If there is a formal plan document, review it to ensure that it contains all material plan provisions, that it incorporates the underlying annuity contracts and custodial accounts, and that it is up to date.
- Make certain that the terms of the written plan are consistent with the terms of the annuity contracts and custodial agreements that are used to fund the plan. Review the annuity contracts and custodial agreements to make certain that they contain the provisions that are required by the regulations.
- If the plan is designed to be exempt from ERISA under Department of Labor regulations[8], ensure that the plan in form and operation does not cause the employer to have discretionary authority in administering the program that will cause it to lose the exemption (also see DOL Field Assistance Bulletin 2007-02).
- If the plan is funded by contracts and custodial accounts issued by multiple vendors, identify who is responsible for overall plan compliance for transactions such as loans or hardship distributions, and memorialize the designation of responsibility in the document.
- If contracts or custodial accounts have been issued prior to 1/01/09 that currently hold plan accumulations but are no longer approved for new contributions, determine whether these funding vehicles are subject to the transition rules of Rev. Proc. 2007-71.

[7] Rev. Proc 2007-71, Appendix for the sample plan document.

[8] See fn 3.

2. Select Vendors and Sign Service Agreements

Requirement: Employers needed to determine which vendors would be considered approved under the plan by January 1, 2009 in order to insure 403(b) compliance responsibilities are properly implemented. The significance of a vendor being part of the plan is that such a vendor must fully share information on participants and transactions with the employer and other vendors in order to help the plan meet its compliance requirements. Any vendor that received plan contributions after December 31, 2008 is considered as part of the plan for this purpose. The regulations do not specifically require a written service agreement be in place as a condition precedent to maintaining favorable 403(b) tax treatment. However, as a practical matter the nature and manner of the information sharing that will be necessary to meet the compliance requirements will require a service agreement.

To Do

- Any vendor that was an approved vendor after December 31, 2008 and received plan contributions will be considered as a vendor under the plan. However, an employer still should consider whether the lineup of vendors is appropriate for the plan and whether the number of vendors hinders its ability to keep the plan in compliance. While the plan will not be able to take advantage of the transition rules (absent an extension of the dates in Rev. Proc. 2007-71) reducing the number of vendors may still simplify the sharing of information and the required compliance activities.

- Identify the party which will be responsible for coordinating the compliance responsibilities. Note that, unlike a 401(a) plan, you will not necessarily be looking to consolidate *financial* reporting, but *compliance* activities. To the extent that the vendors will be delegated the responsibility of performing activities required for compliance, that delegation must be reflected in the written plan[9].

- Determine which sets of old contracts will be considered part of the plan, and which will not be part of the plan using Rev. Proc. 2007-71.

- The data sharing portion of the service agreements should survive the termination of the service agreement.

[9] Treas. Reg 1.403(b)-3(b)(3)(ii)

3. <u>Remedy Post September 24, 2007 Exchanges for Non-current Vendor Contracts</u>

Requirement: Exchanging contracts within a plan after September 24, 2007 is only permissible under certain circumstances, including the requirement that an "information sharing agreement" (ISA) covering such transfers be in place by January 1, 2009 and made retroactive to the date of the exchange.[10] This new rule applies to transfers between contracts issued by vendors that are approved by the plan and receive remittances directly from the employer, and contracts issued by vendors that are not receiving remittances directly from the employer. Prior law permitted tax-free exchange of contracts without involvement of the employer and without exchanging "compliance data" between vendors under an ISA. The regulations restrict such transfers unless the employer and the vendor agree to share information about transactions such as hardship withdrawals, loans, and other distributions, to ensure that the plan complies with section 403(b) and other tax law requirements. If the plan has allowed participants or beneficiaries to exchange contracts since September 24, 2007 for a contract issued by a vendor for which there is not some sort of current service agreement in place which would serve as an ISA, an ISA must be in place by January 1, 2009 that is retroactive to the date of the exchange. Exchanges that occurred prior to September 24, 2007 are not subject to the information sharing requirements. This is another transition rule date that might be extended in light of Notice 2009-3, but has not yet been as of this writing.

To Do:

- Review the list of approved vendors that will be part of the plan, and make certain that each vendor knows which other vendors are permitted to receive transfers. Work with these vendors to determine whether there has been transfers to vendors that are not now part of the plan, and decide whether it wants to continue to allow such exchanges.
- Determine whether such transfers have occurred under your plan since September 24, 2007.
- If the plan has not entered into an Information Sharing Agreement by January 1, 2009 with any vendor that received a transfer since September 24, 2007, consider the application of the transitional rules in Rev. Proc. 2007-71 to address these post-September 24, 2007 transfers ("good faith" procedures if no ISA by January 1, 2009 or re- exchange back into a contract under the plan by June 30, 2009).
- Develop a procedure so that Information Sharing Agreements will be in place with any non-payroll slot vendor that will receive a transfer in the future.

[10] Treas. Reg. 1.403(b)-10(b)(2)(C)

- Alternatively, amend the plan to prohibit transfers to non-payroll slot vendors.
- Communicate any changes in transfer rules to employees.

4. Review excluded classes of employees :

Requirement: The non-discrimination requirements for 403(b) plans have changed. IRS Notice 89-23 is repealed, eliminating some of the excluded categories of employees from the universal availability requirement for elective deferrals (specifically, employees who are covered by a collective bargaining agreement; employees who make a one-time election to participate in a governmental plan under section 414(d); certain professors who are providing services on a temporary basis to another public school for up to one year; and employees who are affiliated with a religious order and who have taken a vow of poverty where the religious order provides for the support of such employees in their retirement.) Notice 89-23 also contained a reasonable good faith standard for testing and disparity safe harbors, which have been repealed. The regulations further explain how to determine if an employee is normally working fewer than 20 hours per week.[11]

To do:

- Review the salary reduction plan. If categories of employees are excluded that now must be included, those employees will need to be included in the salary reduction plan by the relevant effective dates. Note that in most cases the relevant effective date will generally be January 1, 2010 or later. However, the exclusion for collectively bargained employees can have an effective date as early as January 1, 2009.
- If employees who normally work fewer than 20 hours per week are excluded, note there are new definitions in the regulations on the method of counting the 20 hours. If the plan is covered by ERISA, ERISA's 1000 hour rule must also be honored. Consider eliminating the 20 hour exclusion if the plan is subject to ERISA.
- If the disparity safe harbors or the reasonable good faith testing standard in Rev. Proc. 89-23 have been relied upon, you will need to determine whether you will continue to pass non-discrimination using the statutory requirements.
- The new controlled groups rules that may require non-discrimination on a controlled group basis.

5. Hardship Distributions

[11] Treas. Reg. 1.403(b)-5

Requirement: 403(b) hardship distributions must follow the regulations for hardship distributions under section 401(k)[12]. In particular, vendors and employers are no longer entitled to rely upon mere representations by the employee when establishing a hardship exists.

To do:

- Review the hardship distribution procedures followed under the plan (if any) to ensure that they conform to the rules under 401(k); that the employer's system has the ability to suspend contributions for the required period; and that vendors have proper procedures in place. In particular, determine which method of hardship the plan is following and who is responsible (employer, vendor, other service provider) for authorizing hardships.

6. New Withdrawal Restrictions

Requirement: Employer contributions to 403(b) annuity contracts are subject to new withdrawal restrictions. *Under an annuity contract issued after January 1, 2009*, benefits attributable to employer contributions may not be distributed prior to the participant's severance from employment or upon the prior occurrence of some event, such as after a fixed number of years, the attainment of a stated age, or disability.[13]

To do:

- If such distributions are not already restricted by the terms of the plan, choose the events upon which benefits attributable to employer contributions will be distributed and amend your plan.
- Review the annuity contracts that will be issued to fund the plan after January 1, 2009 to ensure that they conform to the restriction on distributions.
- Make sure vendors have the ability to recognize the grandfathered contracts which will maintain the prior rules.

[12] Treas. Reg. 1.403(b)-6

[13] Treas. Reg. 1.403(b)-6

7. Deposit Rules

Requirement: Elective deferrals must be transferred to the funding vehicle within a period that is not longer than is reasonable for the proper administration of the plan.[14] Note that this rule does NOT incorporate the plan asset rules under ERISA, meaning that, should the plan be governed by ERISA, the ERISA rules should be incorporated into the plan document.

To do:

- Plans not covered by ERISA should review procedures governing the remittance of participant elective deferrals to make certain they are being forwarded to the funding vehicles promptly.
- Plans covered by ERISA should already be meeting the ERISA standard.

8. Miscellaneous concerns

To do:

- Understand Information Sharing Agreements. They are technically only a condition precedent for 403(b) treatment on the exchange between vendors within a plan. They are technically not required for transfers between plans. Don't over-sign and over-commit, as ISAs can be demanding on an employer.

- Determine whether termination of the 403(b) plan is appropriate. Termination of a 403(b) plan is now a distributable event,[15] and a new 401(k) plan is not considered a "successor" plan. This makes it incumbent upon the practitioner to determine whether termination of the plan is appropriate. Termination, however, can be a complicated matter because the of the lack of control over the plan's assets make

[14] Treas. Reg 1.403(b)-8

[15] Treas. Reg. 1.403(b)-10

distribution of the assets difficult. Though the distribution of "fully paid annuity contracts" is permitted, such a distribution of custodial accounts may not be.

- Review existing hold harmless agreements. Many 403(b) sponsors, particularly school districts, have "hold harmless" agreements with their vendors. Review these agreements to coordinate their terms with the new service agreements or ISAs.

- Prepare for Form 5500. There are substantially different annual reporting rules in place for ERISA 403(b) plans, some of which will require the collection of "beginning of the year" data on a consolidated basis. Seek advice of the firm providing financials to the plan. In addition, employers that generally employ over 100 employees will be required for the first time to obtain an audit from an Independent Qualified Public Accountant. This may add a substantial cost to the administration of the plan.

- Fix 2009 errors in accordance with Notice 2009-3. If you are taking advantage of the extended due date for plan documents, you must also engage in your "best efforts" to fix compliance errors which occurred during 2009. This appears to be a much tougher standard than "reasonable" or "good faith."

This overview is not meant to be an all-encompassing survey of the rules which will be applicable to any given situation. Particularly, if collective bargained groups, church plans or retirement income accounts are involved, a close look at the rules which specifically apply to those circumstances will need to be reviewed by the practitioner.